Bulletin No. 1997–8
February 24, 1997

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

T.D. 8702, page 4.
Final regulations relate to certain transfers of stock or securities of domestic corporations by U.S. persons to foreign corporations pursuant to the corporate organization, reorganization, or liquidation provisions of section 367 of the Code.

T.D. 8703, page 18.
Final regulations under section 6081 of the Code provide new and simpler procedures for an individual to obtain an automatic extension of time to file an individual income tax return.

T.D. 8704, page 12.
Final regulations under sections 952, 954, and 960 of the Code relate to the definitions of subpart F income and foreign personal holding company income of a controlled foreign corporation and the allocation of deficits to compute the deemed-paid foreign tax credit.

T.D. 8705, page 16.
REG–247862–96, page 32.
Final and temporary regulations under section 6071 of the Code provide that disqualified persons and organization managers liable for Code section 4958 excise taxes are required to file Form 4720.

REG–209494–90, page 24.
Proposed regulations under section 41 of the Code describe when computer software that is developed by (or for the benefit of) a taxpayer, primarily for the taxpayer's internal use, can qualify for the credit for increasing research activities. A public hearing will be held on May 13, 1997.

REG–209839–96, page 26.
Proposed regulations under section 832 of the Code relate to the requirement that insurance companies other than life insurance companies reduce, by 20 percent, their deductions for increases in unearned premiums. A public hearing will be held on April 30, 1997.

REG–246018–96, page 30.
Proposed regulations under section 801 of the Code relate to the definition of life insurance reserves. A public hearing will be held on April 17, 1997.

REG–248770–96, page 33.
Proposed regulations under section 6601 of the Code relate to joint returns, property exempt from levy, interest, penalties, offers in compromise, and the awarding of costs and certain fees.

Notice 97–14, page 23.
Low-income housing tax credit. Resident populations of the various states, for determining the 1997 calendar year (1) state housing credit ceiling under section 42(h) of the Code, and (2) private activity bond volume cap under section 146, are reproduced.

EXEMPT ORGANIZATIONS

Announcement 97–13, page 38.
A Taste of Orange County, Inc., Irvine, CA, no longer qualifies as an organization to which contributions are deductible under section 170 of the Code.

Announcement 97–14, page 38.
A list is given of organizations now classified as private foundations.

EXCISE TAX

Notice 97–15, page 23.
The Service intends to modify section 40.6302(c)–1(c)(2) of the Excise Tax Procedural Regulations to provide that the availability of the safe harbor deposit rule based on look-back quarter liability is limited in cases where a new excise tax is enacted or an expired excise tax is reinstated.

Finding Lists begin on page 41.
Announcement of Disbarments and Suspensions begins on page 40.

Mission of the Service

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness.

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is ''protecting the revenue.'' The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

For sale by the Superintendent of Documents U.S. Government Printing Office, Washington, D.C. 20402.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 367.—Foreign Corporations

26 CFR 1.367(a)–3: Treatment of transfers of stock or securities to foreign corporations.

T.D. 8702

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Certain Transfers of Domestic Stock or Securities by U.S. Persons to Foreign Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to certain transfers of stock or securities of domestic corporations by United States persons to foreign corporations pursuant to the corporate organization, reorganization, or liquidation provisions of the Internal Revenue Code. These final regulations modify the rules contained in the temporary regulations to reflect certain taxpayer comments received in response to those temporary regulations. This action is necessary to provide the public with guidance to comply with the Tax Reform Act of 1984.

DATES: These regulations are effective January 29, 1997. For dates of applicability of these regulations, see § 1.367(a)–3(c)(11).

FOR FURTHER INFORMATION CONTACT: Philip L. Tretiak at (202) 622–3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1478. Responses to these collections of information are required in order for U.S. shareholders that transfer stock or securities in section 367(a) exchanges to qualify for an exception to the general rule of taxation under section 367(a)(1).

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The estimated one-time burden per respondent: 10 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On May 16, 1986, temporary and proposed regulations under sections 367(a) and (d) and section 6038B were published in the **Federal Register** (51 FR 17936 [LR–3–86, 1986–1 C.B. 902]). These regulations were published to provide the public with guidance necessary to comply with changes made to the Internal Revenue Code by the Tax Reform Act of 1984. The IRS and the Treasury Department later issued Notice 87–85 (1987–2 C.B. 395), which set forth substantial changes to the 1986 regulations, effective with respect to transfers occurring after December 16, 1987. A further notice of proposed rulemaking, containing rules under section 367(a), as well as under section 367(b), was published in the **Federal Register** on August 26, 1991 (56 FR 41993 [INTL–54–91; INTL–178–86, 1991–2 C.B. 1070]). The 1991 proposed section 367(a) regulations were generally based upon the positions announced in Notice 87–85, but the regulations made certain modifications to Notice 87–85, particularly with respect to transfers of stock or securities of foreign corporations. Subsequently, the IRS and the Treasury Department issued Notice 94–46 (1994–1 C.B. 356), announcing modifications to the positions set forth in Notice 87–85 (and the 1991 proposed regulations) with respect to transfers of stock or securities of domestic corporations occurring after April 17, 1994.

Most recently, temporary and proposed regulations were published in the **Federal Register** on December 26, 1995 (60 FR 66739 and 66771). The temporary regulations, which are generally effective for transfers occurring after April 17, 1994, but cease to be effective when the final regulations take effect, generally incorporated the positions announced in Notice 94–46, with certain modifications. These final regulations generally follow the rules set forth in the temporary regulations, with changes as described below. Explanation of provisions

Section 367(a)(1) generally treats a transfer of property (including stock or securities) by a U.S. person to a foreign corporation in connection with an exchange described in section 332, 351, 354, 356 or 361 as a taxable exchange unless the transfer qualifies for an exception to this general rule.

Rules that address transfers of stock or securities of domestic corporations are contained in the final regulations described herein. Rules that address transfers of stock or securities of foreign corporations under section 367(a) are contained in Notice 87–85.

The final regulations retain the general rules set forth in the temporary regulations, which provide that a U.S. person that exchanges stock or securities in a U.S. target company (UST) for stock of a foreign corporation (the transferee foreign corporation (or TFC)) in an exchange described in section 367(a) will qualify for nonrecognition treatment if certain reporting requirements are satisfied and each of the following conditions is met:

(i) U.S. transferors must receive no more than 50 percent of the voting power and value of the stock of the TFC in the transfer (*i.e.*, the 50-percent ownership threshold is not exceeded);

(ii) U.S. officers, directors and 5-percent or greater shareholders of the U.S. target must not own, in the aggregate, more than 50 percent of the voting power and value of the TFC immediately after the transfer (*i.e.*, the control group case does not apply);

(iii) The U.S. person (exchanging U.S. shareholder) either must not be a 5-percent transferee shareholder immediately after the transfer or, if the U.S. person is a 5-percent transferee shareholder, must enter into a 5-year gain recognition agreement (GRA) with respect to the UST stock or securities it exchanged. (Without such GRA, the transfer by the 5-percent transferee

shareholder will not qualify for nonrecognition treatment; however, transfers by other U.S. transferors not subject to the GRA requirement may qualify if all other requirements are met.); and

(iv) The active trade or business requirement must be satisfied.

If one or more of the foregoing requirements is not satisfied, the transfer by the U.S. person of stock or securities of a domestic corporation in exchange for stock of a TFC is taxable under section 367(a).

In response to suggestions from commentators, however, the final regulations make a number of modifications to the temporary regulations, principally in two areas: (i) the treatment of transfers of ''other property'' in the context of the 50-percent ownership threshold requirement, and (ii) the active trade or business requirement.

Location:

Transfers of ''Other Property''

Under the temporary regulations, if U.S. transferors receive more than 50 percent of the stock (by vote or value) of the TFC, the 50-percent ownership threshold is exceeded and the transfer is taxable under section 367(a)(1). The temporary regulations define a ''U.S. transferor'' as a U.S. person who transfers (directly, indirectly or constructively) stock or securities of the U.S. target company or ''other property'' for stock of the TFC in an exchange described in section 367. Persons who transfer U.S. target company stock or other property are presumed to be U.S. persons.

The inclusion of ''other property'' in the class of tainted transferred property was designed to prevent the avoidance of the 50-percent ownership threshold through ''stuffing'' transactions. For example, assume that FC, a foreign corporation, and UST, an unrelated U.S. corporation, seek to combine their operations in a new foreign joint venture company (JV). The shareholders of each company will transfer their respective stock interests in UST and FC to JV in a transaction that would qualify as a section 351 exchange unless the transaction was taxable under section 367(a)(1). Assume that FC has all foreign shareholders. The value of the stock of UST is 550x; the value of the stock of FC is 450x. Because UST is more valuable than FC, UST's shareholders would receive more than 50 percent of JV's stock. Consequently, even if the transaction would otherwise qualify for an exception to the general rule of taxation under section 367(a)(1), the transaction would be taxable because the 50-percent ownership threshold would be exceeded. If, however, a U.S. person (X) contributed at least 100x in cash (or property) to JV, JV would not issue more than 50 percent of its stock to the UST shareholders, and, therefore, the 50-percent ownership threshold would not be exceeded. The temporary regulations, however, treat X as a U.S. transferor, so that the 50-percent ownership threshold would be exceeded in this case.

Commentators have pointed out that the term ''other property'' raises issues in the joint venture context that are broader than the ''stuffing'' example described above. Because the term ''other property'' is broad enough to include stock of a foreign company, the transfer of UST stock could be taxable under section 367(a)(1) even if UST were less valuable than the foreign ''target'' company (*i.e.*, in cases where U.S. transferors would receive less than 50 percent of the stock of the joint venture company/TFC). Assume similar facts as in the earlier example, except that FC is widely- held and the shareholders of UST receive 40 percent of the stock of JV, while the shareholders of FC receive the remaining 60 percent. No cash or any other property is transferred to the JV. In such case, if the stock of FC constitutes ''other property,'' UST shareholders would not qualify for an exception to section 367(a)(1) if they were unable to prove that the U.S. shareholders of FC, if any, received no more than 10 percent of the stock of JV in the exchange.

Although the IRS and the Treasury Department remain concerned with ''stuffing'' transactions, the final regulations consider the active trade or business test to be the primary safeguard for preventing tax-motivated transactions from qualifying for an exception under these section 367(a) regulations. In particular, because the active trade or business test addresses ''stuffing'' transactions that occur within the 36-month period prior to the acquisition, the final regulations eliminate consideration of transfers of other property with regard to the 50-percent ownership threshold. Thus, any TFC stock received by U.S. persons in exchange for transfers of other property will not be taken into account in determining whether the 50-percent ownership threshold is exceeded.
Active trade or business test: in general

The final regulations modify the ''active trade or business'' requirement that must be satisfied for a U.S. transferor to qualify for an exception to the general rule of taxability under section 367(a)(1).

Under the requirement contained in the temporary regulations, no exception under section 367(a)(1) is available unless (i) the TFC or an affiliate was engaged in an active trade or business for the entire 36-month period prior to the exchange (the 36-month test), and (ii) such business was substantial in relation to the business of the U.S. target company (the substantiality test). For this purpose, an affiliate is generally defined by reference to the rules in section 1504(a) (without the exclusion of foreign corporations).

The active trade or business test under the final regulations includes (i) a modified 36-month test, (ii) a new anti-avoidance rule requiring that the transaction not be undertaken with an intention that the TFC cease its active trade or business, and (iii) a modified substantiality test. The final regulations make a number of other modifications and clarifications to the active trade or business test. For example, the final regulations permit the TFC to consider only an 80-percent owned foreign subsidiary (referred to as a ''qualified subsidiary''), and not an affiliate, to satisfy the active trade or business test on its behalf.
Active trade or business test: 36-month test and intent test

Under the 36-month test contained in the temporary regulations, the TFC or an affiliate is required to be engaged in an active trade or business for the entire 36 months immediately preceding the date of the transfer. Under the final regulations, this test can be satisfied by acquired businesses that have a 36-month operating history, unless they are acquired with the principal purpose of satisfying the active trade or business test.

In addition to the 36-month test, the active trade or business test in the final regulations contains a requirement that the transaction not be undertaken with an intention that the TFC cease its active business. The IRS and the Treasury Department believe that if a TFC with a 36- month active business history does not intend to maintain such business, but is only used as a vehicle to acquire the UST, an ''inversion'' transaction rather than a synergy of two businesses has been effected.

Under the temporary regulations, there is uncertainty as to whether an affiliate of a newly-formed TFC can

satisfy the active trade or business test on behalf of the TFC for the (36-month) period prior to the exchange. Subject to a stuffing rule, the final regulations clarify that, for purposes of determining whether a TFC satisfies the 36-month test, the TFC may take into account an active business of a company that is a qualified subsidiary immediately after the transaction, even if such company was not a qualified subsidiary for all or part of the 36 months prior to the transaction. Thus, for example, if the TFC is a new foreign joint venture company, it will not be disqualified from satisfying the active trade or business test solely because its qualifying active trade or business was engaged in by a qualified subsidiary whose stock is received in the exchange.

Under the temporary regulations, it is unclear whether a newly-formed joint venture TFC could satisfy the active trade or business test if, in the transaction, it received both stock of a UST (from U.S. transferors) and an active trade or business (*i.e.*, a foreign branch) that had been operating for at least 36 months prior to the exchange (from foreign transferors). This uncertainty arose because the active trade or business test in the temporary regulations required that either the TFC or an affiliate satisfy the 36-month requirement. Although the temporary regulations did not intend to establish a preference for transfers of stock (*i.e.*, affiliates) vis-a-vis assets, the temporary regulations did not expressly provide that a TFC could utilize a newly-transferred foreign branch to satisfy the TFC's active trade or business requirement.

The final regulations clarify that, subject to a stuffing rule, the TFC may satisfy the active trade or business test if it receives in the exchange foreign assets that constituted an active trade or business during such 36-month period. Active trade or business test: qualified subsidiaries

The final regulations permit a TFC to take into account only qualified subsidiaries, rather than affiliates, to satisfy the active trade or business test. This aspect of the active trade or business test has been narrowed because the IRS and the Treasury Department do not believe that a TFC should satisfy the active trade or business exception merely because its parent company (or an affiliate of the parent company) is engaged in an active trade or business.

For example, assume that foreign parent (FP), which is engaged in an active business outside the United States (either directly or through a subsidiary), forms a foreign subsidiary (FS) and contributes cash to FS. Shareholders of a U.S. target company (UST) then transfer all of the stock of UST in exchange for 20 percent of the stock of FS in a transaction described in sections 368(a)(1)(B) and 367(a). If FS is permitted to satisfy the active trade or business test by taking into account FP's business, UST has effectively ''gone offshore'' in an inversion transaction. Because the shareholders of UST receive stock of FS (which is the TFC), and not FP, such shareholders will have no interest in FP's active business. In contrast, if the shareholders received stock of FP in an exchange described in section 367(a), such persons would participate in FP's active business, and the active trade or business test under the final regulations would be satisfied.

Active Trade or Business Test: Partnership Interests

The temporary regulations did not address whether the TFC could satisfy the active trade or business requirement by taking into account an interest in a partnership engaged in an active trade or business.

The final regulations permit a TFC (or a qualified subsidiary) to take into account the active trade or business engaged in outside the United States by any qualified partnership as there defined. Active trade or business test: substantiality test

Under the temporary regulations, the second prong of the active trade or business requirement is the substantiality test. The active trade or business of the TFC is required to be ''substantial'' vis-a-vis the active trade or business of the UST, but the temporary regulations do not define substantiality.

The final regulations modify the substantiality requirement. Under the final regulations, the substantiality test no longer compares the active trade or business of the TFC vis-a-vis the UST. Instead, it requires that the entire value of the TFC be at least equal to the entire value of the UST at the time of the transaction. However, for this purpose, the value of the TFC may include the value of assets (including stock) acquired within the 36-month period prior to the transaction only if (i) such assets were acquired in the ordinary course of business, or (ii) such assets (or their proceeds) do not produce and are not held for the production of passive income (as defined under section 1296(b)), and were not acquired with the principal purpose of satisfying the active trade or business test. A special rule applies if the asset acquired by the TFC in the 36-month period prior to the exchange is stock of a qualified subsidiary or qualified partnership engaged in an active trade or business. In such case, the value of the stock or partnership interest may be taken into account, but must be reduced in accordance with the principles described above.

When formulating the substantiality test under the final regulations, the IRS and the Treasury Department considered and rejected other alternatives considered to be more complex and burdensome for taxpayers. For example, a comparison of the active business of the TFC vis-a-vis the active business of the UST for the 36-month period prior to the acquisition, taking into account the property, payroll and sales of the two companies, was considered and rejected. Indirect and constructive transfers

One commentator suggested that the IRS clarify the definition of ''U.S. Transferor'' contained in the temporary regulations, which refers to a U.S. person who transfers ''directly, indirectly or constructively'' UST stock or other property. The IRS and the Treasury Department believe that the reference to ''direct, indirect and constructive'' transfers may have been unclear and, thus, the final regulations delete such reference. Such technical modification does not modify the substantive law in which indirect and constructive transfers may be treated as transfers subject to section 367(a)(1) (see § 1.367(a)–1T(c)(2) with respect to the ''indirect'' stock transfer rules; constructive transfers include, but are not limited to, section 367(a) transfers that result from section 304 transactions and section 367(a) transfers that result from a change in classification of an entity from a foreign partnership to a foreign corporation). GRA term

Under the temporary regulations, a 5-percent transferee shareholder is required to file a GRA. The duration is 5 years if all U.S. transferors own less than 50 percent of the total voting power and total value of the TFC stock immediately after the transfer. The duration of the GRA is 10 years if the U.S. transferors own 50 percent or more of the TFC stock immediately after the transaction, or if the 5-percent transferee shareholder is unable to prove that all

U.S. transferors own less than 50 percent of the total voting power and total value of the TFC immediately after the transfer. Thus, in determining whether a 5- or 10-year GRA is appropriate, the temporary regulations take into account cross-ownership (*i.e.,* consideration of stock owned independently of the transaction) by all U.S. transferors, and contain a presumption that a 10-year GRA is required.

For example, assume that UST shareholders receive 30 percent of the stock of the TFC in a nonrecognition transaction that qualifies for an exception under section 367(a). Assume further that one UST shareholder, X, a U.S. person, transfers stock of UST in the section 367(a) exchange and owns 5 percent of the TFC after the transaction. Under the temporary regulations, X is required to file a 10-year GRA unless X can prove that all U.S. transferors in the aggregate own less than 50 percent of the voting power and value of the TFC immediately after the transfer (taking into account the 30 percent received in the transaction by U.S. target shareholders plus any other stock that such persons may own independently of the transaction). If the companies are publicly traded or widely-held, it is burdensome and may be impractical for X to rebut the presumption that U.S. transferors own 50 percent or more of the TFC stock.

In response to comments received and in the interest of simplification, the final regulations provide that any 5-percent transferee shareholder that is required to file a GRA upon the transfer of domestic stock or securities is required to file a 5-year GRA; 10-year GRAs will no longer be required in the case of 5-percent transferee shareholders who transfer domestic stock or securities.

Other Areas in Which Comments Were Received

After careful consideration by the IRS and the Treasury Department, the positions set forth in the temporary regulations were generally not modified in response to certain comments other than those described above. For example, the final regulations did not modify: (i) the amount of stock U.S. transferors could receive without exceeding the ownership threshold (*i.e.,* not more than 50 percent), (ii) testing the 50-percent ownership threshold at the time of the exchange, and (iii) the presumption that all shareholders of the U.S. target company are U.S. persons.

PLR Option in Limited Instances

The final regulations provide that, in limited instances, the IRS may consider issuing private letter rulings to taxpayers that (i) satisfy all of the requirements contained in these regulations, with the exception of the active trade or business test, or (ii) make a good faith effort, but are unable to establish non-adverse applicability of the ownership attribution rules. The IRS and the Treasury Department are aware that the active trade or business test is mechanical in nature and, thus, in limited instances, a taxpayer may demonstrate an ongoing and substantial active trade or business even though it fails to meet the test set forth in the final regulations. However, in no event will the IRS rule on the issue of whether a TFC acquired an active business with the principal purpose of satisfying the 36-month test and/or the substantiality test.

Other Matters

The IRS and the Treasury Department expect to issue additional final regulations under section 367(a) to address the transfer of stock or securities of foreign corporations and other matters contained in the 1991 proposed regulations not addressed herein. Until the 1991 proposed regulations are finalized, the positions originally announced in Notice 87–85 will continue to govern the availability of section 367(a) exceptions for transfers of stock or securities of foreign corporations. See § 1.367(a)–3(d).

Special Analyses

It has been determined that this regulation is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that this regulation does not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the number of U.S. target companies that are acquired by foreign corporations in nonrecognition transactions subject to section 367(a), and thus are subject to collection of information, is estimated to be only 100 per year. Moreover, because these regulations will primarily affect large shareholders and U.S. multinational corporations with foreign operations, it is estimated that very few of the 100 transactions will involve small entities. Thus, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Philip L. Tretiak of the Office of Associate Chief Counsel (International), within the Office of Chief Counsel, IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

Part 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.367(a)–3 is added to read as follows:

§ 1.367(a)–3 Treatment of transfers of stock or securities to foreign corporations.

(a) *In general.* This section provides rules concerning the transfer of stock or securities by a U.S. person to a foreign corporation in an exchange described in section 367(a). In general, a transfer of stock or securities by a U.S. person to a foreign corporation that is described in section 351, 354 (pursuant to a reorganization described in section 368(a)(1)(B)) or section 361(a) or (b) is subject to section 367(a)(1) and, therefore, is treated as a taxable exchange, unless one of the exceptions set forth in paragraph (c) or (d) of this section or § 1.367(a)–3T(b) applies. For additional rules relating to an exchange involving a foreign corporation in connection with which there is a transfer of stock, see section 367(b) and the regulations under that section. For additional rules regarding a transfer of stock or securities in an exchange described in section 361(a) or (b), see section 367(a)(5) and any regulations under that section.

(b) [Reserved] For further guidance, see § 1.367(a)– 3T(b).

(c) *Transfers by U.S. persons of stock or securities of domestic corporations to foreign corporations*—(1) In general. Except as provided in section 367(a)(5), a transfer of stock or securities of a domestic corporation by a U.S. person

to a foreign corporation that would otherwise be subject to section 367(a)(1) under paragraph (a) of this section shall not be subject to section 367(a)(1) if the domestic corporation the stock or securities of which are transferred (referred to as the U.S. target company) complies with the reporting requirements in paragraph (c)(6) of this section and if each of the following four conditions is met:

(i) Fifty percent or less of both the total voting power and the total value of the stock of the transferee foreign corporation is received in the transaction, in the aggregate, by U.S. transferors (*i.e.*, the amount of stock received does not exceed the 50-percent ownership threshold).

(ii) Fifty percent or less of each of the total voting power and the total value of the stock of the transferee foreign corporation is owned, in the aggregate, immediately after the transfer by U.S. persons that are either officers or directors of the U.S. target company or that are five-percent target shareholders (as defined in paragraph (c)(5)(iii) of this section) (*i.e.*, there is no control group). For purposes of this paragraph (c)(1)(ii), any stock of the transferee foreign corporation owned by U.S. persons immediately after the transfer will be taken into account, whether or not it was received in the exchange for stock or securities of the U.S. target company.

(iii) Either—

(A) The U.S. person is not a five-percent transferee shareholder (as defined in paragraph (c)(5)(ii) of this section); or

(B) The U.S. person is a five-percent transferee shareholder and enters into a five-year agreement to recognize gain with respect to the U.S. target company stock or securities it exchanged in the form provided in § 1.367(a)–3T(g); and

(iv) The active trade or business test (as defined in paragraph (c)(3) of this section) is satisfied.

(2) *Ownership presumption.* For purposes of paragraph (c)(1) of this section, persons who transfer stock or securities of the U.S. target company in exchange for stock of the transferee foreign corporation are presumed to be U.S. persons. This presumption may be rebutted in accordance with paragraph (c)(7) of this section.

(3) *Active trade or business test*—(i) *In general*. The tests of this paragraph (c)(3), collectively referred to as the active trade or business test, are satisfied if:

(A) The transferee foreign corporation or any qualified subsidiary (as defined in paragraph (c)(5)(vii) of this section) or any qualified partnership (as defined in paragraph (c)(5)(viii) of this section) is engaged in an active trade or business outside the United States, within the meaning of § 1.367(a)–2T(b)(2) and (3), for the entire 36-month period immediately before the transfer;

(B) At the time of the transfer, neither the transferors nor the transferee foreign corporation (and, if applicable, the qualified subsidiary or qualified partnership engaged in the active trade or business) have an intention to substantially dispose of or discontinue such trade or business; and

(C) The substantiality test (as defined in paragraph (c)(3)(iii) of this section) is satisfied.

(ii) *Special rules.* For purposes of paragraphs (c)(3)(i)(A) and (B) of this section, the following special rules apply:

(A) The transferee foreign corporation, a qualified subsidiary, or a qualified partnership will be considered to be engaged in an active trade or business for the entire 36-month period preceding the exchange if it acquires at the time of, or any time prior to, the exchange a trade or business that has been active throughout the entire 36-month period preceding the exchange. This special rule shall not apply, however, if the acquired active trade or business assets were owned by the U.S. target company or any affiliate (within the meaning of section 1504(a) but excluding the exceptions contained in section 1504(b) and substituting ''50 percent'' for ''80 percent'' where it appears therein) at any time during the 36-month period prior to the acquisition. Nor will this special rule apply if the principal purpose of such acquisition is to satisfy the active trade or business test.

(B) An active trade or business does not include the making or managing of investments for the account of the transferee foreign corporation or any affiliate (within the meaning of section 1504(a) but excluding the exceptions contained in section 1504(b) and substituting ''50 percent'' for ''80 percent'' where it appears therein). (This paragraph (c)(3)(ii)(B) shall not create any inference as to the scope of § 1.367(a)–2T(b)(2) and (3) for other purposes.)

(iii) *Substantiality test*—(A) *General rule.* A transferee foreign corporation will be deemed to satisfy the substantiality test if, at the time of the transfer, the fair market value of the transferee foreign corporation is at least equal to the fair market value of the U.S. target company.

(B) *Special rules.* (1) For purposes of paragraph (c)(3)(iii)(A) of this section, the value of the transferee foreign corporation shall include assets acquired outside the ordinary course of business by the transferee foreign corporation within the 36-month period preceding the exchange only if either—

(*i*) Both—

(*A*) At the time of the exchange, such assets or, as applicable, the proceeds thereof, do not produce, and are not held for the production of, passive income as defined in section 1296(b); and

(*B*) Such assets are not acquired for the principal purpose of satisfying the substantiality test; or

(*ii*) Such assets consist of the stock of a qualified subsidiary or an interest in a qualified partnership. See paragraph (c)(3)(iii)(B)(*2*) of this section.

(*2*) For purposes of paragraph (c)(3)(iii)(A) of this section, the value of the transferee foreign corporation shall not include the value of the stock of any qualified subsidiary or the value of any interest in a qualified partnership, held directly or indirectly, to the extent that such value is attributable to assets acquired by such qualified subsidiary or partnership outside the ordinary course of business and within the 36-month period preceding the exchange unless those assets satisfy the requirements in paragraph (c)(3)(iii)(B)(*1*) of this section.

(*3*) For purposes of paragraph (c)(3)(iii)(A) of this section, the value of the transferee foreign corporation shall not include the value of assets received within the 36-month period prior to the acquisition, notwithstanding the special rule in paragraph (c)(3)(iii)(B)(*1*) of this section, if such assets were owned by the U.S. target company or an affiliate (within the meaning of section 1504(a) but without the exceptions under section 1504(b) and substituting ''50 percent'' for ''80 percent'' where it appears therein) at any time during the 36-month period prior to the transaction.

(4) *Special rules*—(i) *Treatment of partnerships*. For purposes of this paragraph (c), if a partnership (whether domestic or foreign) owns stock or securities in the U.S. target company or the transferee foreign corporation, or transfers stock or securities in an ex-

change described in section 367(a), each partner in the partnership, and not the partnership itself, is treated as owning and as having transferred, or as owning, a proportionate share of the stock or securities. See § 1.367(a)–1T(c)(3).

(ii) *Treatment of options.* For purposes of this paragraph (c), one or more options (or an interest similar to an option) will be treated as exercised and thus will be counted as stock for purposes of determining whether the 50-percent threshold is exceeded or whether a control group exists if a principal purpose of the issuance or the acquisition of the option (or other interest) was the avoidance of the general rule contained in section 367(a)(1).

(iii) *U.S. target has a vestigial ownership interest in transferee foreign corporation.* In cases where, immediately after the transfer, the U.S. target company owns, directly or indirectly (applying the attribution rules of sections 267(c)(1) and (5)), stock of the transferee foreign corporation, that stock will not in any way be taken into account (and, thus, will not be treated as outstanding) in determining whether the 50-percent threshold under paragraph (c)(1)(i) of this section is exceeded or whether a control group under paragraph (c)(1)(ii) of this section exists.

(iv) *Attribution rule.* Except as otherwise provided in this section, the rules of section 318, as modified by the rules of section 958(b), shall apply for purposes of determining the ownership or receipt of stock, securities or other property under this paragraph (c).

(5) *Definitions*—(i) *Ownership statement.* An ownership statement is a statement, signed under penalties of perjury, stating—

(A) The identity and taxpayer identification number, if any, of the person making the statement;

(B) That the person making the statement is not a U.S. person (as defined in paragraph (c)(5)(iv) of this section);

(C) That the person making the statement either—

(*1*) Owns less than 1 percent of the total voting power and total value of a U.S. target company the stock of which is described in Rule 13d–1(d) of Regulation 13D (17 CFR 240.13d–1(d)) (or any rule or regulation to generally the same effect) promulgated by the Securities and Exchange Commission under the Securities and Exchange Act of 1934 (15 USC 78m), and such person did not acquire the stock with a principal purpose to enable the U.S. transferors to satisfy the requirement contained in paragraph (c)(1)(i) of this section; or

(*2*) Is not related to any U.S. person to whom the stock or securities owned by the person making the statement are attributable under the rules of section 958(b), and did not acquire the stock with a principal purpose to enable the U.S. transferors to satisfy the requirement contained in paragraph (c)(1)(i) of this section;

(D) The citizenship, permanent residence, home address, and U.S. address, if any, of the person making the statement; and

(E) The ownership such person has (by voting power and by value) in the U.S. target company prior to the exchange and the amount of stock of the transferee foreign corporation (by voting power and value) received by such person in the exchange.

(ii) *Five-percent transferee shareholder.* A five-percent transferee shareholder is a person that owns at least five percent of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer described in section 367(a)(1). For special rules involving cases in which stock is held by a partnership, see paragraph (c)(4)(i) of this section.

(iii) *Five-percent target shareholder and certain other 5-percent shareholders.* A five-percent target shareholder is a person that owns at least five percent of either the total voting power or the total value of the stock of the U.S. target company immediately prior to the transfer described in section 367(a)(1). If the stock of the U.S. target company (or any company through which stock of the U.S. target company is owned indirectly or constructively) is described in Rule 13d–1(d) of Regulation 13D (17 CFR 240.13d–1(d)) (or any rule or regulation to generally the same effect), promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 USC 78m), then, in the absence of actual knowledge to the contrary, the existence or absence of filings of Schedule 13–D or 13–G (or any similar schedules) may be relied upon for purposes of identifying five-percent target shareholders (or a five-percent shareholder of a corporation which itself is a five-percent shareholder of the U.S. target company). For special rules involving cases in which U.S. target company stock is held by a partnership, see paragraph (c)(4)(i) of this section.

(iv) *U.S. Person.* For purposes of this section, a U.S. person is defined by reference to § 1.367(a)–1T(d)(1). For application of the rules of this section to stock or securities owned or transferred by a partnership that is a U.S. person, however, see paragraph (c)(4)(i) of this section.

(v) *U.S. Transferor.* A U.S. transferor is a U.S. person (as defined in paragraph (c)(5)(iv) of this section) that transfers stock or securities of one or more U.S. target companies in exchange for stock of the transferee foreign corporation in an exchange described in section 367.

(vi) *Transferee foreign corporation.* A transferee foreign corporation is the foreign corporation whose stock is received in the exchange by U.S. persons.

(vii) *Qualified Subsidiary.* A qualified subsidiary is a foreign corporation whose stock is at least 80-percent owned (by total voting power and total value), directly or indirectly, by the transferee foreign corporation. However, a corporation will not be treated as a qualified subsidiary if it was affiliated with the U.S. target company (within the meaning of section 1504(a) but without the exceptions under section 1504(b) and substituting ''50 percent'' for ''80 percent'' where it appears therein) at any time during the 36-month period prior to the transfer. Nor will a corporation be treated as a qualified subsidiary if it was acquired by the transferee foreign corporation at any time during the 36-month period prior to the transfer for the principal purpose of satisfying the active trade or business test, including the substantiality test.

(viii) *Qualified partnership.* (A) Except as provided in paragraph (c)(5)-(viii)(B) or (C) of this section, a qualified partnership is a partnership in which the transferee foreign corporation—

(*1*) Has active and substantial management functions as a partner with regard to the partnership business; or

(*2*) Has an interest representing a 25 percent or greater interest in the partnership's capital and profits.

(B) A partnership is not a qualified partnership if the U.S. target company or any affiliate of the U.S. target company (within the meaning of section 1504(a) but without the exceptions under section 1504(b) and substituting ''50 percent'' for ''80 percent'' where it appears therein) held a 5 percent or greater interest in the partnership's capi-

tal and profits at any time during the 36-month period prior to the transfer.

(C) A partnership is not a qualified partnership if the transferee foreign corporation's interest was acquired by that corporation at any time during the 36-month period prior to the transfer for the principal purpose of satisfying the active trade or business test, including the substantiality test.

(6) *Reporting requirements of U.S. target company.* (i) In order for a U.S. person that transfers stock or securities of a domestic corporation to qualify for the exception provided by this paragraph (c) to the general rule under section 367(a)(1), in cases where 10 percent or more of the total voting power or the total value of the stock of the U.S. target company is transferred by U.S. persons in the transaction, the U.S. target company must comply with the reporting requirements contained in this paragraph (c)(6). The U.S. target company must attach to its timely filed U.S. income tax return for the taxable year in which the transfer occurs a statement titled ''Section 367(a)—Reporting of Cross-Border Transfer Under Reg. § 1.367(a)–3(c)(6),'' signed under penalties of perjury by an officer of the corporation to the best of the officer's knowledge and belief, disclosing the following information—

(A) A description of the transaction in which a U.S. person or persons transferred stock or securities in the U.S. target company to the transferee foreign corporation in a transfer otherwise subject to section 367(a)(1);

(B) The amount (specified as to the percentage of the total voting power and the total value) of stock of the transferee foreign corporation received in the transaction, in the aggregate, by persons who transferred stock or securities of the U.S. target company. For additional information that may be required to rebut the ownership presumption of paragraph (c)(2) of this section in cases where more than 50 percent of either the total voting power or the total value of the stock of the transferee foreign corporation is received in the transaction, in the aggregate, by persons who transferred stock or securities of the U.S. target company, see paragraph (c)(7) of this section;

(C) The amount (if any) of transferee foreign corporation stock owned directly or indirectly (applying the attribution rules of sections 267(c)(1) and (5)) immediately after the exchange by the U.S. target company;

(D) A statement that there is no control group within the meaning of paragraph (c)(1)(ii) of this section;

(E) A list of U.S. persons who are officers, directors or five-percent target shareholders and the percentage of the total voting power and the total value of the stock of the transferee foreign corporation owned by such persons both immediately before and immediately after the transaction; and

(F) A statement that includes the following—

(*1*) A statement that the active trade or business test described in paragraph (c)(3) of this section is satisfied by the transferee foreign corporation and a description of such business;

(*2*) A statement that on the day of the transaction, there was no intent on the part of the transferors or the transferee foreign corporation (or any qualified subsidiary or any qualified partnership, if relevant) to substantially dispose of or discontinue its active trade or business; and

(*3*) A statement that the substantiality test described in paragraph (c)(3)(iii) of this section is satisfied, and documentation that such test is satisfied, including the value of the transferee foreign corporation and the value of the U.S. target company on the day of the transfer, and either one of the following—

(*i*) A statement demonstrating that the value of the transferee foreign corporation 36 months prior to the acquisition, plus the value of any assets described in paragraph (c)(3)(iii)(B) of this section (including stock) acquired by the transferee foreign corporation within the 36-month period, less the amount of any liabilities acquired during that period, exceeds the value of the U.S. target company on the acquisition date; or

(*ii*) A statement demonstrating that the value of the transferee foreign corporation on the date of the acquisition, reduced by the value of any assets not described in paragraph (c)(3)(iii)(B) of this section (including stock) acquired by the transferee foreign corporation within the 36-month period, exceeds the value of the U.S. target company on the date of the acquisition.

(ii) For purposes of this paragraph (c)(6), an income tax return will be considered timely filed if such return is filed, together with the statement required by this paragraph (c)(6), on or before the last date for filing a Federal income tax return (taking into account any extensions of time therefor) for the taxable year in which the transfer occurs. If a return is not timely filed within the meaning of this paragraph (c)(6), the District Director may make a determination, based on all facts and circumstances, that the taxpayer had reasonable cause for its failure to file a timely filed return and, if such a determination is made, the requirement contained in this paragraph (c)(6) shall be waived.

(7) *Ownership statements.* To rebut the ownership presumption of paragraph (c)(2) of this section, the U.S. target company must obtain ownership statements (described in paragraph (c)(5)(i) of this section) from a sufficient number of persons that transfer U.S. target company stock or securities in the transaction that are not U.S. persons to demonstrate that the 50-percent threshold of paragraph (c)(1)(i) of this section is not exceeded. In addition, the U.S. target company must attach to its timely filed U.S. income tax return (as described in paragraph (c)(6)(ii) of this section) for the taxable year in which the transfer occurs a statement, titled ''Section 367(a)–Compilation of Ownership Statements under Reg. § 1.367(a)–3(c),'' signed under penalties of perjury by an officer of the corporation, disclosing the following information:

(i) The amount (specified as to the percentage of the total voting power and the total value) of stock of the transferee foreign corporation received, in the aggregate, by U.S. transferors;

(ii) The amount (specified as to the percentage of total voting power and total value) of stock of the transferee foreign corporation received, in the aggregate, by foreign persons that filed ownership statements;

(iii) A summary of the information tabulated from the ownership statements, including—

(A) The names of the persons that filed ownership statements stating that they are not U.S. persons;

(B) The countries of residence and citizenship of such persons; and

(C) Each of such person's ownership (by voting power and by value) in the U.S. target company prior to the exchange and the amount of stock of the transferee foreign corporation (by voting power and value) received by such persons in the exchange.

(8) *Certain transfers in connection with performance of services.* Section 367(a)(1) shall not apply to a domestic corporation's transfer of its own stock or securities in connection with the performance of services, if the transfer is

considered to be to a foreign corporation solely by reason of § 1.83–6(d)(1).

(9) *Private letter ruling option.* The Internal Revenue Service may, in limited circumstances, issue a private letter ruling to permit the taxpayer to qualify for an exception to the general rule under section 367(a)(1) if—

(i) A taxpayer is unable to satisfy all of the requirements of paragraph (c)(3) of this section relating to the active trade or business test of paragraph (c)(1)(iv) of this section, but such taxpayer meets all of the other requirements contained in paragraphs (c)(1)(i) through (c)(1)(iii) of this section, and such taxpayer is substantially in compliance with the rules set forth in paragraph (c)(3) of this section; or

(ii) A taxpayer is unable to satisfy any requirement of paragraph (c)(1) of this section due to the application of paragraph (c)(4)(iv) of this section. Notwithstanding the preceding sentence, in no event will the Internal Revenue Service rule on the issue of whether the principal purpose of an acquisition was to satisfy the active trade or business test, including the substantiality test.

(10) *Examples.* This paragraph (c) may be illustrated by the following examples:

Example 1. Ownership presumption. (i) FC, a foreign corporation, issues 51 percent of its stock to the shareholders of S, a domestic corporation, in exchange for their S stock, in a transaction described in section 367(a)(1).

(ii) Under paragraph (c)(2) of this section, all shareholders of S who receive stock of FC in the exchange are presumed to be U.S. persons. Unless this ownership presumption is rebutted, the condition set forth in paragraph (c)(1)(i) of this section will not be satisfied, and the exception in paragraph (c)(1) of this section will not be available. As a result, all U.S. persons that transferred S stock will recognize gain on the exchange. To rebut the ownership presumption, S must comply with the reporting requirements contained in paragraph (c)(7) of this section, obtaining ownership statements (described in paragraph (c)(5)(i) of this section) from a sufficient number of non-U.S. persons who received FC stock in the exchange to demonstrate that the amount of FC stock received by U.S. persons in the exchange does not exceed 50 percent.

Example 2. Filing of Gain Recognition Agreement. (i) The facts are the same as in *Example 1*, except that FC issues only 40 percent of its stock to the shareholders of S in the exchange. FC satisfies the active trade or business test of paragraph (c)(1)(iv) of this section. A, a U.S. person, owns 10 percent of S's stock immediately before the transfer. All other shareholders of S own less than five percent of its stock. None of S's officers or directors owns any stock in FC immediately after the transfer. A will own 15 percent of the stock of FC immediately after the transfer, 4 percent received in the exchange, and the balance being stock in FC that A owned prior to and independent of the transaction. No S shareholder besides A owns five percent or more of FC immediately after the transfer. The reporting requirements under paragraph (c)(6) of this section are satisfied.

(ii) The condition set forth in paragraph (c)(1)(i) of this section is satisfied because, even after application of the presumption in paragraph (c)(2) of this section, U.S. transferors could not receive more than 50 percent of FC's stock in the transaction. There is no control group because five-percent target shareholders and officers and directors of S do not, in the aggregate, own more than 50 percent of the stock of FC immediately after the transfer (A, the sole five-percent target shareholder, owns 15 percent of the stock of FC immediately after the transfer, and no officers or directors of S own any stock of FC immediately after the transfer). Therefore, the condition set forth in paragraph (c)(1)(ii) of this section is satisfied. The facts assume that the condition set forth in paragraph (c)(1)(iv) of this section is satisfied. Thus, U.S. persons that are not five-percent transferee shareholders will not recognize gain on the exchange of S shares for FC shares. A, a five-percent transferee shareholder, will not be required to include in income any gain realized on the exchange in the year of the transfer if he files a 5-year gain recognition agreement (GRA) and complies with section 6038B.

Example 3. Control Group. (i) The facts are the same as in *Example 2*, except that B, another U.S. person, is a 5-percent target shareholder, owning 25 percent of S's stock immediately before the transfer. B owns 40 percent of the stock of FC immediately after the transfer, 10 percent received in the exchange, and the balance being stock in FC that B owned prior to and independent of the transaction.

(ii) A control group exists because A and B, each a five-percent target shareholder within the meaning of paragraph (c)(5)(iii) of this section, together own more than 50 percent of FC immediately after the transfer (counting both stock received in the exchange and stock owned prior to and independent of the exchange). As a result, the condition set forth in paragraph (c)(1)(ii) of this section is not satisfied, and all U.S. persons (not merely A and B) who transferred S stock will recognize gain on the exchange.

Example 4. Partnerships. (i) The facts are the same as in *Example 3*, except that B is a partnership (domestic or foreign) that has five equal partners, only two of whom, X and Y, are U.S. persons. Under paragraph (c)(4)(i) of this section, X and Y are treated as the owners and transferors of 5 percent each of the S stock owned and transferred by B and as owners of 8 percent each of the FC stock owned by B immediately after the transfer. U.S. persons that are five-percent target shareholders thus own a total of 31 percent of the stock of FC immediately after the transfer (A's 15 percent, plus X's 8 percent, plus Y's 8 percent).

(ii) Because no control group exists, the condition in paragraph (c)(1)(ii) of this section is satisfied. The conditions in paragraphs (c)(1)(i) and (iv) of this section also are satisfied. Thus, U.S. persons that are not five-percent transferee shareholders will not recognize gain on the exchange of S shares for FC shares. A, X, and Y, each a five-percent transferee shareholder, will not be required to include in income in the year of the transfer any gain realized on the exchange if they file 5-year GRAs and comply with section 6038B.

(11) *Effective date.* This paragraph (c) applies to transfers occurring after January 29, 1997. However, taxpayers may elect to apply this section in its entirety to all transfers occurring after April 17, 1994, provided that the statute of limitations of the affected tax year or years is open.

(d) *Transfers of stock or securities of foreign corporations.* For guidance, see Notice 87–85 (1987–2 C.B. 395). See § 601.601(d)(2) of this chapter.

(e) through (h) [Reserved] For further guidance, see § 1.367(a)–3T(e) through (h).

Par. 3. In § 1.367(a)–3T, paragraphs (a), (c) and (d) are revised to read as follows:

§ 1.367(a)–3T Treatment of transfers of stock or securities to foreign corporations (temporary).

(a) [Reserved] For further information, see § 1.367(a)–3(a).

* * * * *

(c) and (d) [Reserved] For further information, see § 1.367(a)–3(c) and (d).

* * * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority for citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805

Par. 5. Section 602.101, paragraph (c) is amended by revising the entry for 1.367(a)–3T and adding an entry to the table in numerical order to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.367(a)–3	1545–0026
	1545–1478
1.367(a)–3T.	1545–0026
* * * * *	

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved December 11, 1996.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 27, 1996, 8:45 a.m., and published in the issue of the Federal Register for December 30, 1996, 61 F.R. 68633)

Section 952.—Subpart F Income Defined

26 CFR 1.952–1: Subpart F income defined.

T.D. 8704

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Definition of Foreign Base Company Income and Foreign Personal Holding Company Income of a Controlled Foreign Corporation

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the definitions of subpart F income and foreign personal holding company income of a controlled foreign corporation and the allocation of deficits for purposes of computing the deemed-paid foreign tax credit. These regulations are necessary to provide guidance that coordinates with previously published guidance under section 954. These regulations will affect United States shareholders of controlled foreign corporations.

DATES: These regulations are effective January 2, 1997.

For specific dates of applicability, see §§ 1.952–1(f)(5), 1.952–2(c)(1), 1.954–2(b)(3) and 1.960–1(i)(6).

FOR FURTHER INFORMATION CONTACT: Valerie Mark, (202) 622–3840 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

On September 7, 1995, proposed regulations (IL–75–92 [1995–2 C.B. 480]) amending the Income Tax Regulations (26 CFR Part 1) under sections 952, 954(c) and 960 of the Internal Revenue Code (Code) were published in the **Federal Register** (60 FR 46548). In final regulations under section 954 (T.D. 8618 [1995–2 C.B. 89]), also published on that date (60 FR 46500), a provision relating to the treatment of tax-exempt interest under the foreign personal holding company income rules was reserved. The proposed regulations provided rules for the treatment of tax-exempt interest and also provided guidance under sections 952 and 960 to coordinate with the final regulations. No public hearing was requested or held. One written comment was received on the proposed regulations. After consideration of this comment, the proposed regulations are adopted as final regulations without amendment.

Explanation of Provisions

§ 1.952–1(e) and (f) and 1.960–1(i)

Sections 1.952–1(e) and (f) and 1.960–1(i) are unchanged from the proposed regulations.

§§ 1.952–2(c)(1) and 1.954–2(b)(3)

Under § 1.954–2T(b)(6), interest income that was exempt from tax under section 103 was included in the foreign personal holding company income of the controlled foreign corporation. However, the net foreign base company income that was attributable to tax-exempt interest was treated as tax-exempt interest in the hands of the United States shareholder upon a deemed distribution under subpart F and therefore excluded for regular tax purposes but potentially subject to the alternative minimum tax. Section 1.954–2(b)(3), as proposed and finalized, amends the rule in the temporary regulations to provide that foreign personal holding company income includes interest income that is exempt from tax under section 103. The tax-exempt interest would not retain its character as such in the hands of the United States shareholder upon a deemed distribution under subpart F. As a result of the treatment of tax-exempt interest in these final regulations, Rev. Rul. 72–527 (1972–2 C.B. 456) is obsoleted.

A commentator argued that treatment of tax-exempt interest in the proposed regulations was contrary to section 103. This comment was rejected. The Code does not specifically address how section 103 applies in the context of subpart F. Although § 1.952–2 provides that, in general, U.S. tax principles apply in computing subpart F income, this regulation makes certain Code provisions inapplicable when necessary to serve the purposes of subpart F. See § 1.952–2(c)(1).

§ 1.954–1(d)(4)(iii)

The example in § 1.954–1(d)(4)(iii) is amended to correct a mathematical error.

§ 1.954–2(g)(2)

The regulations are amended to clarify that income derived in the trade or business of trading foreign currency is not excluded from foreign personal holding company income under the business needs exception. A technical correction is made to § 1.954–2(g)-(2)(ii)(B)(*2*).

§ 1.957–1(c)

Technical corrections are made to § 1.957–1(c) *Examples 8* and *9*.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Barbara Felker and Valerie Mark of the Office of the Associate Chief Counsel (International), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805. * * *

Section 1.960–1 also issued under 26 U.S.C. 960(a). * * *

Par. 2. Section 1.952–1 is amended by adding paragraphs (e) and (f) to read as follows:

§ 1.952–1 Subpart F income defined.

* * * * *

(e) *Application of current earnings and profits limitation*—(1) *In general.* If the subpart F income (as defined in section 952(a)) of a controlled foreign corporation exceeds the foreign corporation's earnings and profits for the taxable year, the subpart F income includible in the income of the corporation's United States shareholders is reduced under section 952(c)(1)(A) in accordance with the following rules. The excess of subpart F income over current year earnings and profits shall—

(i) First, proportionately reduce subpart F income in each separate category of the controlled foreign corporation, as defined in § 1.904–5(a)(1), in which current earnings and profits are zero or less than zero;

(ii) Second, proportionately reduce subpart F income in each separate category in which subpart F income exceeds current earnings and profits; and

(iii) Third, proportionately reduce subpart F income in other separate categories.

(2) *Allocation to a category of subpart F income.* An excess amount that is allocated under paragraph (e)(1) of this section to a separate category must be further allocated to a category of subpart F income if the separate category contains more than one category of subpart F income described in section 952(a) or, in the case of foreign base company income, described in § 1.954–1(c)(1)-(iii)(A)(*1*) or (*2*). In such case, the excess amount that is allocated to the separate category must be allocated to the various categories of subpart F income within that separate category on a proportionate basis.

(3) *Recapture of subpart F income reduced by operation of earnings and profits limitation.* Any amount in a category of subpart F income described in section 952(a) or, in the case of foreign base company income, described in § 1.954–1(c)(1)(iii)(A)(*1*) or (*2*) that is reduced by operation of the current year earnings and profits limitation of section 952(c)(1)(A) and this paragraph (e) shall be subject to recapture in a subsequent year under the rules of section 952(c)(2) and paragraph (f) of this section.

(4) *Coordination with sections 953 and 954.* The rules of this paragraph (e) shall be applied after the application of sections 953 and 954 and the regulations under those sections, except as provided in § 1.954–1(d)(4)(ii).

(5) *Earnings and deficits retain separate limitation character.* The income reduction rules of paragraph (e)(1) of this section shall apply only for purposes of determining the amount of an inclusion under section 951(a)(1)(A) from each separate category as defined in § 1.904–5(a)(1) and the separate categories in which recapture accounts are established under section 952(c)(2) and paragraph (f) of this section. For rules applicable in computing post-1986 undistributed earnings, see generally section 902 and the regulations under that section. For rules relating to the allocation of deficits for purposes of computing foreign taxes deemed paid under section 960 with respect to an inclusion under section 951(a)(1)(A), see § 1.960–1(i).

(f) *Recapture of subpart F income in subsequent taxable year*—(1) *In general.* If a controlled foreign corporation's subpart F income for a taxable year is reduced under the current year earnings and profits limitation of section 952(c)(1)(A) and paragraph (e) of this section, recapture accounts will be established and subject to recharacterization in any subsequent taxable year to the extent the recapture accounts were not previously recharacterized or distributed, as provided in paragraphs (f)(2) and (3) of this section.

(2) *Rules of recapture*—(i) *Recapture account.* If a category of subpart F income described in section 952(a) or, in the case of foreign base company income, described in § 1.954–1(c)(1)-(iii)(A)(*1*) or (*2*) is reduced under the current year earnings and profits limitation of section 952(c)(1)(A) and paragraph (e) of this section for a taxable year, the amount of such reduction shall constitute a recapture account.

(ii) *Recapture.* Each recapture account of the controlled foreign corporation will be recharacterized, on a proportionate basis, as subpart F income in the same separate category (as defined in § 1.904–5(a)(1)) as the recapture account to the extent that current year earnings and profits exceed subpart F income in a taxable year. The United States shareholder must include his pro rata share (determined under the rules of § 1.951–1(e)) of each recharacterized amount in income as subpart F income in such separate category for the taxable year.

(iii) *Reduction of recapture account and corresponding earnings.* Each recapture account, and post-1986 undistributed earnings in the separate category containing the recapture account, will be reduced in any taxable year by the amount which is recharacterized under paragraph (f)(2)(ii) of this section. In addition, each recapture account, and post-1986 undistributed earnings in the separate category containing the recapture account, will be reduced in the amount of any distribution out of that account (as determined under the ordering rules of section 959(c) and paragraph (f)(3)(ii) of this section).

(3) *Distribution ordering rules*—(i) *Coordination of recapture and distribution rules.* If a controlled foreign corporation distributes an amount out of earnings and profits described in section 959(c)(3) in a year in which current year earnings and profits exceed subpart F income and there is an amount in a recapture account for such year, the recapture rules will apply first.

(ii) *Distributions reduce recapture accounts first.* Any distribution made by a controlled foreign corporation out of earnings and profits described in section 959(c)(3) shall be treated as made first on a proportionate basis out of the recapture accounts in each separate category to the extent thereof (even if the amount in the recapture account exceeds post-1986 undistributed earnings in the separate category containing the recapture account). Any remaining distribution shall be treated as made on a proportionate basis out of the remaining earnings and profits of the controlled foreign corporation in each separate category. See section 904(d)(3)(D).

(4) *Examples.* The application of paragraphs (e) and (f) of this section may be illustrated by the following examples:

Example 1. (i) A, a U.S. person, is the sole shareholder of CFC, a controlled foreign corporation formed on January 1, 1998, whose functional currency is the u. In 1998, CFC earns 100u of foreign base company sales income that is general limitation income described in section 904(d)(1)(I) and incurs a (200u) loss attributable to activities that would have produced general limitation income that is not subpart F income. In 1998 CFC also earns 100u of foreign personal holding company income that is passive income described in section 904(d)(1)(A), and 100u of foreign personal holding company income that is dividend income subject to a separate limitation described in section 904(d)(1)(E) for dividends from a noncontrolled section 902 corporation. CFC's subpart F income for 1998, 300u, exceeds CFC's current earnings and profits, 100u, by 200u. Under section 952(c)(1)(A) and paragraph (e) of this section, subpart F income is limited to CFC's current earnings and profits of 100u, all of which is included in A's gross income under section 951(a)(1)(A). The 200u of CFC's 1998 subpart F income that is not included in A's income in 1998

by reason of section 952(c)(1)(A) is subject to recapture under section 952(c)(2) and paragraph (f) of this section.

(ii) For purposes of determining the amount and type of income included in A's gross income and the amount and type of income in CFC's recapture account, the rules of paragraphs (e)(1) and (2) of this section apply. Under paragraph (e)(1)(i) of this section, the amount by which CFC's subpart F income exceeds its earnings and profits for 1998, 200u, first reduces from 100u to 0 CFC's subpart F income in the general limitation category, which has a current year deficit of (100u) in earnings and profits. Next, under paragraph (e)(1)(iii) of this section, the remaining 100u by which CFC's 1998 subpart F income exceeds earnings and profits is applied proportionately to reduce CFC's subpart F income in the separate categories for passive income (100u) and dividends from the noncontrolled section 902 corporation (100u). Thus, A includes 50u of passive limitation/foreign personal holding company income and 50u of dividends from the noncontrolled section 902 corporation/foreign personal holding company income in gross income in 1998. CFC has 100u in its general limitation/foreign base company sales income recapture account attributable to the 100u of foreign base company sales income that is not included in A's income by reason of the earnings and profits limitation of section 952(c)(1)(A). CFC also has 50u in its passive limitation recapture account, all of which is attributable to foreign personal holding company income, and 50u in its recapture account for dividends from the noncontrolled section 902 corporation, all of which is attributable to foreign personal holding company income.

(iii) For purposes of computing post-1986 undistributed earnings, the rules of sections 902 and 960, including the rules of § 1.960–1(i), apply. Under § 1.960–1(i), the general limitation deficit of (100u) is allocated proportionately to reduce passive limitation earnings of 100u and noncontrolled section 902 dividend earnings of 100u. Thus, passive limitation earnings are reduced by 50u to 50u (100u passive limitation earnings/200u total earnings in positive separate categories x (100u) general limitation deficit = 50u reduction), and the noncontrolled section 902 corporation earnings are reduced by 50u to 50u (100u noncontrolled section 902 corporation earnings/200u total earnings in positive separate categories x (100u) general limitation deficit = 50u reduction). All of CFC's post-1986 foreign income taxes with respect to passive limitation income and dividends from the noncontrolled section 902 corporation are deemed paid by A under section 960 with respect to the subpart F inclusions (50u inclusion/50u earnings in each separate category). After the inclusion and deemed-paid taxes are computed, at the close of 1998 CFC has a (100u) deficit in general limitation earnings (100u subpart F earnings + (200u) nonsubpart F loss), 50u of passive limitation earnings (100u of earnings attributable to foreign personal holding company income - 50u inclusion) with a corresponding passive limitation/foreign personal holding company income recapture account of 50u, and 50u of earnings subject to a separate limitation for dividends from the noncontrolled section 902 corporation (100u earnings - 50u inclusion) with a corresponding noncontrolled section 902 corporation/foreign personal holding company income recapture account of 50u.

Example 2. (i) The facts are the same as in *Example 1* with the addition of the following facts. In 1999, CFC earns 100u of foreign base company sales income that is general limitation income and 100u of foreign personal holding company income that is passive limitation income. In addition, CFC incurs (10u) of expenses that are allocable to its separate limitation for dividends from the noncontrolled section 902 corporation. Thus, CFC's subpart F income for 1999, 200u, exceeds CFC's current earnings and profits, 190u, by 10u. Under section 952(c)(1)(A) and paragraph (e) of this section, subpart F income is limited to CFC's current earnings and profits of 190u, all of which is included in A's gross income under section 951(a)(1)(A).

(ii) For purposes of determining the amount and type of income included in A's gross income and the amount and type of income in CFC's recapture accounts, the rules of paragraphs (e)(1) and (2) of this section apply. While CFC's general limitation post-1986 undistributed earnings for 1999 are 0 ((100u) opening balance + 100u subpart F income), CFC's general limitation subpart F income (100u) does not exceed its general limitation current earnings and profits (100u) for 1999. Accordingly, under paragraph (e)(1)(iii) of this section, the amount by which CFC's subpart F income exceeds its earnings and profits for 1999, 10u, is applied proportionately to reduce CFC's subpart F income in the separate categories for general limitation income, 100u, and passive income, 100u. Thus, A includes 95u of general limitation foreign base company sales income and 95u of passive limitation foreign personal holding company income in gross income in 1999. At the close of 1999 CFC has 105u in its general limitation/foreign base company sales income recapture account (100u from 1998 + 5u from 1999), 55u in its passive limitation/foreign personal holding company income recapture account (50u from 1998 + 5u from 1999), and 50u in its dividends from the noncontrolled section 902 corporation/foreign personal holding company income recapture account (all from 1998).

(iii) For purposes of computing post-1986 undistributed earnings in each separate category, the rules of sections 902 and 960, including the rules of § 1.960–1(i), apply. Thus, post-1986 undistributed earnings (or an accumulated deficit) in each separate category are increased (or reduced) by current earnings and profits or current deficits in each separate category. The accumulated deficit in CFC's general limitation earnings and profits (100u) is reduced to 0 by the addition of 100u of 1999 earnings and profits. CFC's passive limitation earnings of 50u are increased by 100u to 150u, and CFC's noncontrolled section 902 corporation earnings of 50u are decreased by (10u) to 40u. After the addition of current year earnings and profits and deficits to the separate categories there are no deficits remaining in any separate category. Thus, the allocation rules of § 1.960–1(i)(4) do not apply in 1999. Accordingly, in determining the post-1986 foreign income taxes deemed paid by A, post-1986 undistributed earnings in each separate category are unaffected by earnings in the other categories. Foreign taxes deemed paid under section 960 for 1999 would be determined as follows for each separate category: with respect to the inclusion of 95u of foreign base company sales income out of general limitation earnings, the section 960 fraction is 95u inclusion/0 total earnings; with respect to the inclusion of 95u of passive limitation income the section 960 fraction is 95u inclusion/150u passive earnings. Thus, no general limitation taxes would be associated with the inclusion of the general limitation earnings because there are no accumulated earnings in the general limitation category. After the deemed-paid taxes are computed, at the close of 1999 CFC has a (95u) deficit in general limitation earnings and profits ((100u) opening balance + 100u current earnings - 95u inclusion), 55u of passive limitation earnings and profits (50u opening balance + 100u current foreign personal holding company income - 95u inclusion), and 40u of earnings and profits subject to the separate limitation for dividends from the noncontrolled section 902 corporation (50u opening balance + (10u) expense).

Example 3. (i) A, a U.S. person, is the sole shareholder of *CFC*, a controlled foreign corporation whose functional currency is the u. At the beginning of 1998, CFC has post-1986 undistributed earnings of 275u, all of which are general limitation earnings described in section 904(d)(1)(I). CFC has no previously-taxed earnings and profits described in section 959(c)(1) or (c)(2). In 1998, CFC has a (200u) loss in the shipping category described in section 904(d)(1)(D), 100u of foreign personal holding company income that is passive income described in section 904(d)(1)(A), and 125u of general limitation manufacturing earnings that are not subpart F income. CFC's subpart F income for 1998, 100u, exceeds CFC's current earnings and profits, 25u, by 75u. Under section 952(c)(1)(A) and paragraph (e) of this section, subpart F income is limited to CFC's current earnings and profits of 25u, all of which is included in A's gross income under section 951(a)(1)(A). The 75u of CFC's 1998 subpart F income that is not included in A's income in 1998 by reason of section 952(c)(1)(A) is subject to recapture under section 952(c)(2) and paragraph (f) of this section.

(ii) For purposes of determining the amount and type of income included in A's gross income and the amount and type of income in CFC's recapture account, the rules of paragraphs (e)(1) and (2) of this section apply. Under paragraph (e)(1) of this section, the amount of CFC's subpart F income in excess of earnings and profits for 1998, 75u, reduces the 100u of passive limitation foreign personal holding company income. Thus, A includes 25u of passive limitation foreign personal holding company income in gross income, and CFC has 75u in its passive limitation/foreign personal holding company income recapture account.

(iii) For purposes of computing post-1986 undistributed earnings in each separate category the rules of sections 902 and 960, including the rules of § 1.960–1(i), apply. Under § 1.960– 1(i), the shipping limitation deficit of (200u) is allocated proportionately to reduce general limitation earnings of 400u and passive limitation earnings of 100u. Thus, general limitation earnings are reduced by 160u to 240u (400u general limitation earnings/500u total earnings in positive separate categories x (200u) shipping deficit = 160u reduction), and passive limitation earnings are reduced by 40u to 60u (100u passive earnings/500u total earnings in positive separate categories x (200u) shipping deficit = 40u reduction). Five-twelfths of CFC's post-1986 foreign income taxes with respect to passive limitation earnings are deemed paid by A under section 960 with respect to the subpart F inclusion (25u inclusion/60u passive earnings). After the inclusion and deemed-paid taxes are computed, at the close of 1998 CFC has 400u of general limitation earnings (275u opening balance + 125u current earnings), 75u of passive limitation earnings (100u of foreign personal holding company income - 25u inclusion), and a (200u) deficit in shipping limitation earnings.

Example 4. (i) The facts are the same as in *Example 3* with the addition of the following facts. In 1999, CFC earns 50u of general limitation earnings that are not subpart F income and 75u of passive limitation income that is foreign personal holding company income. Thus, CFC has 125u of current earnings and profits. CFC distributes 200u to A. Under paragraph (f)(3)(i) of this section, the recapture rules are applied first. Thus, the amount by which 1999 current earnings and profits exceed subpart F income, 50u, is recharacterized as passive limitation foreign personal holding company income. CFC's total subpart F income for 1999 is 125u of passive limitation foreign personal holding company income (75u current earnings plus 50u recapture account), and the passive limitation/foreign personal holding company income recapture account is reduced from 75u to 25u.

(ii) CFC has 150u of previously-taxed earnings and profits described in section 959(c)(2) (25u attributable to 1998 and 125u attributable to 1999), all of which is passive limitation earnings and profits. Under section 959(c), 150u of the 200u distribution is deemed to be made from earnings and profits described in section 959(c)(2). The remaining 50u is deemed to be made from earnings and profits described in section 959(c)(3). Under paragraph (f)(3)(ii) of this section, the dividend distribution is deemed to be made first out of the passive limitation recapture account to the extent thereof (25u). Under paragraph (f)(2)(iii) of this section, the passive limitation recapture account is reduced from 25u to 0. The remaining distribution of 25u is treated as made out of CFC's general limitation earnings and profits.

(iii) For purposes of computing post-1986 undistributed earnings, the rules of section 902 and 960, including the rules of § 1.960–1(i), apply. Thus, the shipping limitation accumulated deficit of (200u) reduces general limitation earnings and profits of 450u and passive limitation earnings and profits of 150u on a proportionate basis. Thus, 100% of CFC's post-1986 foreign income taxes with respect to passive limitation earnings are deemed paid by A under section 960 with respect to the 1999 subpart F inclusion of 125u (100u inclusion (numerator limited to denominator)/100u passive earnings). No post-1986 foreign income taxes remain to be deemed paid under section 902 in connection with the 25u distribution from the passive limitation/foreign personal holding company income recapture account. One-twelfth of CFC's post-1986 foreign income taxes with respect to general limitation earnings are deemed paid by A under section 902 with respect to the distribution of 25u general limitation earnings and profits described in section 959(c)(3) (25u inclusion/300u general limitation earnings). After the deemed-paid taxes are computed, at the close of 1999 CFC has 425u of general limitation earnings and profits (400u opening balance + 50u current earnings - 25u distribution), 0 of passive limitation earnings (75u recapture account + 75u current foreign personal holding company income - 125u inclusion - 25u distribution), and a (200u) deficit in shipping limitation earnings.

(5) *Effective date.* Paragraph (e) of this section and this paragraph (f) apply to taxable years of a controlled foreign corporation beginning after March 3, 1997.

Par. 3. In § 1.952–2, paragraph (c)(1) is revised to read as follows:

§ 1.952–2 Determination of gross income and taxable income of a foreign corporation.

* * * * *

(c) *Special rules for purposes of this section—(1) Nonapplication of certain provisions.* Except where otherwise distinctly expressed, the provisions of subchapters F, G, H, L, M, N, S, and T of chapter 1 of the Internal Revenue Code shall not apply and, for taxable years of a controlled foreign corporation beginning after March 3, 1997, the provisions of section 103 of the Internal Revenue Code shall not apply.

* * * * *

Par. 4. In § 1.954–1, the Example in paragraph (d)(4)(iii) is revised to read as follows:

§ 1.954–1 Foreign base company income.

* * * * *

(d) * * *
(4) * * *
(iii) * * *

Example. During its 1995 taxable year, CFC, a controlled foreign corporation, earns royalty income, net of taxes, of $100 that is foreign personal holding company income. CFC has no expenses associated with this royalty income. CFC pays $50 of foreign income taxes with respect to the royalty income. For 1995, CFC has current earnings and profits of $50. CFC's subpart F income, as determined prior to the application of this paragraph (d), exceeds its current earnings and profits. Thus, under paragraph (d)(4)(ii) of this section, the amount of CFC's only net item of income, the royalty income, will be limited to $50. The remaining $50 will be subject to recharacterization in a subsequent taxable year under section 952(c)(2). Because the amount of foreign income taxes paid with respect to this net item of income is $50, the effective rate of tax on the item, for purposes of this paragraph (d), is 50 percent ($50 of taxes/$50 net item + $50 of taxes). Accordingly, an election under paragraph (d)(5) of this section may be made to exclude the item of income from the computation of subpart F income.

* * * * *

Par. 5. In § 1.954–2, paragraphs (b)(3), (g)(2)(ii)(B)(1)(i) and (g)(2)(ii)-(B)(2) are revised to read as follows:

§ 1.954–2 Foreign personal holding company income.

* * * * *

(b) * * *

(3) *Treatment of tax exempt interest.* For taxable years of a controlled foreign corporation beginning after March 3, 1997, foreign personal holding company income includes all interest income, including interest that is described in section 103 (see § 1.952–2(c)(1)).

* * * * *

(g) * * *
(2) * * *
(ii) * * *
(B) * * *
(*1*) * * *

(*i*) Arises from a transaction (other than a hedging transaction) entered into, or property used or held for use, in the normal course of the controlled foreign corporation's trade or business, other than the trade or business of trading foreign currency;

* * * * *

(*2*) The foreign currency gain or loss arises from a bona fide hedging transaction, as defined in paragraph (a)(4)(ii) of this section, with respect to a transaction or property that satisfies the requirements of paragraphs (g)(2)(ii)(B)(*1*)(*i*) through (*iii*) of this section, provided that any gain or loss arising from such transaction or property that is attributable to changes in exchange rates is clearly determinable from the records of the CFC as being derived from such transaction or property. For purposes of this paragraph (g)(2)(ii)(B)(*2*), a hedging transaction will satisfy the aggregate hedging rules of § 1.1221–2(c)(7) only if all (or all but a de minimis amount) of the aggregate risk being hedged arises in connection with transactions or property that satisfy the requirements of paragraphs (g)(2)(ii)(B)(*1*)(*i*) through (*iii*) of this section, provided that any gain or loss arising from such transactions or property that is attributable to changes in exchange rates is clearly determinable from the records of the CFC as being derived from such transactions or property.

* * * * *

Par. 6. Section 1.957–1 is amended by:

1. Removing the last sentence of paragraph (c) Example 8 and adding two sentences in its place.

2. Revising the last sentence of paragraph (c) Example 9

The addition and revision read as follows:

§ 1.957–1 Definition of controlled foreign corporation.

* * * * *

(c) * * *

Example 8. JV was a controlled foreign corporation on the following day because over 50 percent of the total value in the corporation was

held by a person that was a United States shareholder under section 951(b). See § 1.951–1(f).

Example 9. JV became a controlled foreign corporation on the following day because over 50 percent of the total value in the corporation was held by a person that was a United States shareholder under section 951(b).

* * * * *

Par. 7. In § 1.960–1, paragraph (i) is added to read as follows:

§ 1.960–1 Foreign tax credit with respect to taxes paid on earnings and profits of controlled foreign corporations.

* * * * *

(i) *Computation of deemed-paid taxes in post-1986 taxable years*—(1) *General rule.* If a domestic corporation is eligible to compute deemed-paid taxes under section 960(a)(1) with respect to an amount included in gross income under section 951(a), then, such domestic corporation shall be deemed to have paid a portion of the foreign corporation's post-1986 foreign income taxes determined under section 902 and the regulations under that section in the same manner as if the amount so included were a dividend paid by such foreign corporation (determined by applying section 902(c) in accordance with section 904(d)(3)(B)).

(2) *Ordering rule for computing deemed-paid taxes under sections 902 and 960.* If a domestic corporation computes deemed-paid taxes under both sections 902 and 960 in the same taxable year, section 960 shall be applied first. After the deemed-paid taxes are computed under section 960 with respect to a deemed income inclusion, post-1986 undistributed earnings and post-1986 foreign income taxes in each separate category shall be reduced by the appropriate amounts before deemed-paid taxes are computed under section 902 with respect to a dividend distribution.

(3) *Computation of post-1986 undistributed earnings.* Post-1986 undistributed earnings (or an accumulated deficit in post-1986 undistributed earnings) are computed under section 902 and the regulations under that section.

(4) *Allocation of accumulated deficits.* For purposes of computing post-1986 undistributed earnings under sections 902 and 960, a post-1986 accumulated deficit in a separate category shall be allocated proportionately to reduce post-1986 undistributed earnings in the other separate categories. However, a deficit in any separate category shall not permanently reduce earnings in other separate categories, but after the deemed-paid taxes are computed the separate limitation deficit shall be carried forward in the same separate category in which it was incurred. In addition, because deemed-paid taxes may not exceed taxes paid or accrued by the controlled foreign corporation, in computing deemed-paid taxes with respect to an inclusion out of a separate category that exceeds post-1986 undistributed earnings in that separate category, the numerator of the deemed-paid credit fraction (deemed inclusion from the separate category) may not exceed the denominator (post-1986 undistributed earnings in the separate category).

(5) *Examples.* The application of this paragraph (i) may be illustrated by the following examples. See § 1.952–1(f)(4) for additional illustrations of these rules.

Example 1. (i) A, a U.S. person, is the sole shareholder of CFC, a controlled foreign corporation formed on January 1, 1998, whose functional currency is the u. In 1998 CFC earns 100u of general limitation income described in section 904(d)(1)(I) that is not subpart F income and 100u of foreign personal holding company income that is passive income described in section 904(d)(1)(A). In 1998 CFC also incurs a (50u) loss in the shipping category described in section 904(d)(1)(D). CFC's subpart F income for 1998, 100u, does not exceed CFC's current earnings and profits of 150u. Accordingly, all 100u of CFC's subpart F income is included in A's gross income under section 951(a)(1)(A). Under section 904(d)(3)(B) of the Internal Revenue Code and paragraph (i)(1) of this section, A includes 100u of passive limitation income in gross income for 1998.

(ii) For purposes of computing post-1986 undistributed earnings under sections 902, 904(d) and 960 with respect to the subpart F inclusion, the shipping limitation deficit of (50u) is allocated proportionately to reduce general limitation earnings of 100u and passive limitation earnings of 100u. Thus, general limitation earnings are reduced by 25u to 75u (100u general limitation earnings/200u total earnings in positive separate categories x (50u) shipping deficit = 25u reduction), and passive limitation earnings are reduced by 25u to 75u (100u passive earnings/200u total earnings in positive separate categories x (50u) shipping deficit = 25u reduction). All of CFC's post-1986 foreign income taxes with respect to passive limitation earnings are deemed paid by A under section 960 with respect to the 100u subpart F inclusion of passive income (75u inclusion (numerator limited to denominator under paragraph (i)(4) of this section)/75u passive earnings). After the inclusion and deemed-paid taxes are computed, at the close of 1998 CFC has 100u of general limitation earnings, 0 of passive limitation earnings (100u of foreign personal holding company income - 100u inclusion), and a (50u) deficit in shipping limitation earnings.

Example 2. (i) The facts are the same as in *Example 1* with the addition of the following facts. In 1999, CFC distributes 150u to A. CFC has 100u of previously-taxed earnings and profits described in section 959(c)(2) attributable to 1998, all of which is passive limitation earnings and profits. Under section 959(c), 100u of the 150u distribution is deemed to be made from earnings and profits described in section 959(c)(2). The remaining 50u is deemed to be made from earnings and profits described in section 959(c)(3). The entire dividend distribution of 50u is treated as made out of CFC's general limitation earnings and profits. See section 904(d)(3)(D).

(ii) For purposes of computing post-1986 undistributed earnings under section 902 with respect to the 1999 dividend of 50u, the shipping limitation accumulated deficit of (50u) reduces general limitation earnings and profits of 100u to 50u. Thus, 100% of CFC's post-1986 foreign income taxes with respect to general limitation earnings are deemed paid by A under section 902 with respect to the 1999 dividend of 50u (50u dividend/50u general limitation earnings). After the deemed-paid taxes are computed, at the close of 1999 CFC has 50u of general limitation earnings (100u opening balance - 50u distribution), 0 of passive limitation earnings, and a (50u) deficit in shipping limitation earnings. (6) Effective date. This paragraph (i) applies to taxable years of a controlled foreign corporation beginning after March 3, 1997.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved December 11, 1996.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 31, 1996, 8:45 a.m., and published in the issue of the Federal Register for January 2, 1997, 62 F.R. 17)

Section 6071.—Time for Filing Returns and Other Documents

26 CFR 53.6071–1T: Time for filing returns (temporary).

T.D. 8705

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 53

Requirement of Return and Time for Filing

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations providing that disqualified persons and organization managers liable for Internal Revenue Code section 4958 excise taxes are required to file Form 4720. The regulations also specify the filing date for returns for the period to which the new

excise taxes applied retroactively. These excise taxes are imposed on excess benefit transactions between disqualified persons, as statutorily defined, and sections 501(c)(3) and (4) organizations, except for private foundations.

DATES: These regulations are effective January 2, 1997.

For dates of applicability, see § 53.6071–1T(f) of these regulations.

FOR FURTHER INFORMATION CONTACT: Phyllis Haney, (202) 622–4290 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Foundation and Similar Excise Taxes regulations (26 CFR part 53) under sections 6011 and 6071. These regulations provide guidance relating to the requirement of a return to accompany payment of section 4958 excise taxes and the time for filing that return. These rules were first published in Notice 96–46 (1996–39 I.R.B. 7) (September 23, 1996).

Taxpayer Bill of Rights 2, Public Law 104–168, 110 Stat. 1452 (TBOR2), enacted July 30, 1996, added section 4958 to the Code. As described more fully below, section 4958 imposes excise taxes on excess benefit transactions. Section 4958 taxes apply retroactively to excess benefit transactions occurring on or after September 14, 1995. The taxes do not, however, apply to any benefit arising from a transaction pursuant to any written contract which was binding on September 13, 1995, and at all times thereafter before such transaction occurred.

An ''excess benefit transaction'' subject to tax under section 4958 is any transaction in which an economic benefit is provided by an organization described in section 501(c)(3) (except for a private foundation) or 501(c)(4) directly or indirectly to, or for the use of, any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing the benefit. A ''disqualified person'' is any person who was, at any time during the 5-year period ending on the date of the excess benefit transaction, in a position to exercise substantial influence over the affairs of the organization. Disqualified persons also include family members and certain entities in which at least 35 percent of the control or beneficial interest are held by persons described in the preceding sentence. An ''organization manager'' is any officer, director, trustee, or any individual having powers or responsibilities similar to those of any officer, director, or trustee.

Section 4958 imposes three taxes. The first tax is equal to 25 percent of the excess benefit amount, and is to be paid by any disqualified person who engages in an excess benefit transaction. The second tax is equal to 200 percent of the excess benefit amount, and is to be paid by any disqualified person if the excess benefit transaction is not corrected within the taxable period. The third tax is equal to 10 percent of the excess benefit amount, and is to be paid by any organization manager who knowingly participates in an excess benefit transaction. The maximum amount of this third tax with respect to any one excess benefit transaction may not exceed $10,000. These regulations prescribe Form 4720 for calculating and paying the first and third taxes described above.

TBOR2 also amended section 6033(b) to require section 501(c)(3) organizations to report the amounts of the taxes paid under section 4958 with respect to excess benefit transactions involving the organization, as well as any other information the Secretary may require concerning those transactions. Section 6033(f) also was amended to impose the same reporting requirements on section 501(c)(4) organizations. Those amendments to section 6033 only apply to organizations' returns for taxable years beginning after July 30, 1996. These and other TBOR2 amendments to the reporting requirements for section 501(c)(3) and (4) organizations are reflected on IRS Forms 990 and 990–EZ beginning with the 1996 versions.

Explanation of Provisions

The regulations provide that disqualified persons and organization managers, as defined in sections 4958(f)(1) and (2), who are liable for section 4958 excise taxes on excess benefit transactions, as defined in section 4958(c)(1), are required to file a return on Form 4720. The general rule is that returns will be due on or before the 15th day of the fifth month following the close of the disqualified person's or organization manager's taxable year. The regulations also provide that returns on Form 4720 for taxable years ending after September 13, 1995, and on or before July 30, 1996, will be due on or before December 15, 1996. See Notice 96–46 (1996–39 I.R.B. 7) (September 23, 1996).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Phyllis Haney, Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 53 is amended as follows:

PART 53—FOUNDATION AND SIMILAR EXCISE TAXES

Paragraph 1. The authority citation for part 53 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 2. In § 53.6011–1, paragraph (b) is amended by:

1. Removing from the first sentence, the language ''or 4955(a),'' and adding '', 4955(a), or 4958(a),'' in its place.

2. Removing from the last sentence, the language ''or 4955(a),'' and adding '', 4955(a), or 4958(a),'' in its place.

Par. 3. Section 53.6071–1T is added to read as follows:

§ 53.6071–1T Time for filing returns (temporary).

(a) through (e) [Reserved]. For further guidance see § 53.6071–1(a) through (e).

(f) *Taxes imposed on excess benefit transactions engaged in by organizations described in sections 501(c)(3)*

(except private foundations) and 501(c)(4)—(1) *General rule.* A Form 4720 required by § 53.6011–1(b) for a disqualified person or organization manager liable for tax imposed by section 4958(a) shall be filed by that person on or before the 15th day of the fifth month following the close of such person's taxable year.

(2) *Special rule for taxable years ending after September 13, 1995, and on or before July 30, 1996.* A Form 4720 required by § 53.6011–1(b) for a disqualified person or organization manager liable for tax imposed by section 4958(a) on an excess benefit transaction occurring in such person's taxable year ending after September 13, 1995, and on or before July 30, 1996, is due on or before December 15, 1996.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved December 10, 1996.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 31, 1996, 8:45 a.m., and published in the issue of the Federal Register for January 2, 1997, 62 F.R. 25)

Section 6081.—Extension of Time for Filing Returns

26 CFR 1.6081–4: Automatic extension of time for filing individual income tax returns.

T.D. 8703

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1, 301, and 602

Automatic Extension of Time for Filing Individual Income Tax Returns; Automatic Extension of Time to File Partnership Return of Income, Trust Income Tax Return, and U.S. Real Estate Mortgage Investment Conduit Income Tax Return

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that reflect new and simpler procedures for an individual to obtain an automatic extension of time to file an individual income tax return. This document also contains final regulations that provide new and simpler procedures for a partnership, trust, and Real Estate Mortgage Investment Conduit (REMIC) to obtain an automatic extension of time to file partnership, trust, and REMIC returns.

EFFECTIVE DATE: The regulations are effective December 31, 1996.

FOR FURTHER INFORMATION CONTACT: Margaret A. Owens, (202) 622–6232 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3504(h)) under control numbers 1545–1479 and 1545–0148. Responses to this collection of information are required to obtain a benefit (an automatic 4-month extension of time to file an individual income tax return or an automatic 3-month extension of time to file a partnership return of income, a trust income tax return, or a REMIC income tax return).

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

Estimates of the reporting burden in these final regulations are reflected in the burden estimates of either Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return, or Form 8736, Application for Automatic Extension of Time To File U.S. Return for a Partnership, REMIC or for Certain Trusts.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Extensions for Individual Income Tax Returns

On January 4, 1996, temporary regulations (T.D. 8651 [1996–1 C.B. 312]) providing new and simpler procedures for individuals to obtain an automatic extension of time to file an individual income tax return were published in the **Federal Register** (6l FR 260). A notice of proposed rulemaking (IA–41–93 [1996–1 C.B. 770]) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (61 FR 338).

Written comments responding to the notice of proposed rulemaking were received. No public hearing was requested or held. After consideration of all the comments, the temporary regulations under sections 6081 and 6651 relating to the automatic extension of time to file individual income tax returns are adopted as revised by this Treasury Decision, and the corresponding temporary regulations are removed. The comments and revisions are discussed below in the section on Explanation of Provisions and Summary of Comments.

Extensions for Partnership Returns of Income and Trust Income Tax Returns

On April 5, 1988, temporary regulations (T.D. 8190 [1988–1 C.B. 394]) relating to the automatic extension of time to file partnership returns of income and trust income tax returns were published in the **Federal Register** (53 FR 11066). A notice of proposed rulemaking (LR–29–88 [1988–1 C.B. 934]) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (53 FR 11103).

In accordance with section 860F(e), REMICs have been generally treated as partnerships with regard to extensions of time to file. A REMIC has been allowed an automatic 3-month extension of time to file if (1) an application was prepared on Form 8736, (2) the application was signed by the person duly authorized, (3) the application was filed on or before the date Form 1066, U.S. Real Estate Mortgage Investment Conduit Income Tax Return, was due, (4) the application showed the full amount properly estimated as tax, and (5) the application was accompanied by full remittance of the amount properly esti-

mated as tax that was unpaid as of the date prescribed for filing Form 1066.

Written comments responding to the notice of proposed rulemaking and the request for comments were received. No public hearing was requested or held. After consideration of all the comments, the temporary regulations under section 6081 relating to the automatic extension of time to file partnership returns of income, trust income tax returns, and REMIC income tax returns are adopted as revised by this Treasury decision, and the corresponding temporary regulations are removed. The comments and revisions are discussed below.

Explanation of Provisions and Summary of Comments

These final regulations provide that individuals may obtain an automatic 4-month extension of time to file an individual income tax return without remitting the unpaid amount of any tax properly estimated to be due with the application for extension of time to file. Under these final regulations, an individual's inability to pay is not a condition for obtaining an automatic 4-month extension. However, taxpayers are encouraged to make payments in order to minimize interest and penalties imposed on unpaid amounts.

The final regulations remove the regulatory requirement that Forms 4868 be signed.

Most commentators responded favorably to the proposed and temporary regulations. Some commentators suggested that the IRS should develop a bulk method for submitting applications for automatic extensions so that return preparers could submit a list of the required information for all their clients on one Form 4868. The final regulations provide that the IRS may prescribe other methods for submitting an application in lieu of a paper application on Form 4868. In April 1996, the IRS provided a method of filing Forms 4868 electronically through the Electronic Transmitted Documents System. See Publication 1346. The IRS continues to offer this method of filing Forms 4868. If there is still a need for other methods, suggestions should be sent to: CC:DOM:CORP:R (REG–209643–93), Room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044.

One commentator recommended that the requirement to ''properly estimate'' the tax be dropped, since payment of the unpaid amount of tax due is not a condition of obtaining an automatic 4-month extension of time to file an individual income tax return. The requirement has been retained to assist taxpayers in determining the amount of interest and penalties for which they will be liable if timely tax payments are not made, and to thereby encourage payments, as large as possible, with the application for extension of time to file.

The final regulations provide the requirements for partnerships, trusts, and REMICs to obtain an automatic 3-month extension of time to file partnership, trust, and REMIC returns. The final regulations remove the regulatory requirement that Forms 8736 be signed. Notwithstanding the current instructions to Form 8736, an unsigned Form 8736 will be processed. In addition, these final regulations provide that trusts and REMICs may obtain an automatic 3-month extension of time to file a trust income tax return or a REMIC income tax return without remitting the unpaid amount of any tax properly estimated to be due with the application for extension of time to file.

The final regulations provide that the IRS may prescribe additional methods of obtaining an extension of time to file in lieu of a paper application on Form 8736.

Some commentators suggested that allowing automatic extensions for partnership returns of income and trust income tax returns will give rise to filing difficulties for partners and trust beneficiaries. The Treasury and the IRS took this concern into account when limiting partnership and trust extensions to 3 months rather than the 4 months permitted individuals.

Special Analyses

It has been determined that these final regulations are not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the notices of proposed rulemaking preceding the regulations were issued prior to March 29, 1996, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, a copy of the notice of proposed rulemaking providing an automatic extension of time to file an individual income tax return that precedes these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal authors of these regulations are Margaret A. Owens, and Philip E. Bennet, Office of the Assistant Chief Counsel (Income Tax & Accounting), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 301, and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding new entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.6081–2 also issued under 26 U.S.C. 6081(a).

Section 1.6081–4 also issued under 26 U.S.C. 6081(a).

Section 1.6081–6 also issued under 26 U.S.C. 6081(a).

Section 1.6081–7 also issued under 26 U.S.C. 6081(a).* * *

Par. 2. Section 1.6081–2 is added to read as follows:

§ 1.6081–2 Automatic extension of time to file partnership return of income.

(a) *In general.* A partnership required to file a return of income on Form 1065, U.S. Partnership Return of Income, for any taxable year will be allowed an automatic 3-month extension of time to file the return after the date prescribed for filing the return if an application under this section is filed in accordance with paragraph (b) of this section. In the case of a partnership described in § 1.6081–5(a)(1), the automatic extension allowed under this section runs concurrently with an extension of time to file granted pursuant to § 1.6081–5(a).

(b) *Requirements.* In order to satisfy this paragraph (b), an application for an automatic extension under this section must be—

(1) Submitted on Form 8736, Application for Automatic Extension of Time

To File U.S. Return for a Partnership, REMIC or for Certain Trusts, or in any other manner as may be prescribed by the Commissioner;

(2) Filed on or before the later of—

(i) The date prescribed for filing the partnership return (without regard to any extensions of the time for filing such return); or

(ii) The expiration of any extension of time to file granted such partnership pursuant to § 1.6081–5(a); and

(3) Filed with the Internal Revenue Service office designated in the application's instructions.

(c) *Payment of section 7519 amount.* An automatic extension of time for filing a partnership return under this section does not extend the time for payment of any amount due under section 7519, relating to required payments for entities electing not to have a required taxable year.

(d) *Section 444 election.* An automatic extension of time for filing a partnership return will run concurrently with any extension of time for filing a return allowed because of section 444, relating to the election of a taxable year other than a required taxable year.

(e) *Effect of extension on partner.* An automatic extension of time for filing a partnership return under this section does not operate to extend the time for filing a partner's income tax return or the time for the payment of any tax due on the partner's income tax return.

(f) *Termination of automatic extension.* The district director, including the Assistant Commissioner (International), or the director of a service center may terminate at any time an automatic extension by mailing to the partnership a notice of termination. The notice must be mailed at least 10 days prior to the termination date designated in such notice. The notice of termination must be mailed to the address shown on Form 8736 or to the partnerships's last known address.

(g) *Penalties.* See section 6698 for failure to file a partnership return.

(h) *Coordination with § 1.6081–1.* Except in undue hardship cases, no extension of time for filing a partnership return of income will be granted under § 1.6081–1 until an automatic extension has been allowed pursuant to the provisions of this section.

(i) *Effective date.* This section is effective for applications for an automatic extension of time to file a partnership return of income filed on or after December 31, 1996.

§ 1.6081–2T [Removed]

Par. 3. Section 1.6081–2T is removed.

§ 1.6081–3T [Removed]

Par. 4. Section 1.6081–3T is removed.

Par. 5. Section 1.6081–4 is amended as follows:

1. Paragraphs (a) and (c) are revised.

2. Paragraphs (d) and (e) are added.

The revised and added provisions read as follows:

§ 1.6081–4 Automatic extension of time for filing individual income tax returns.

(a) *In general*—(1) *Period of extension.* An individual who is required to file an individual income tax return will be allowed an automatic 4-month extension of time to file the return after the date prescribed for filing the return provided the requirements contained in paragraphs (a)(2), (3), and (4) of this section are met. In the case of an individual described in § 1.6081–5(a)(5) or (6), the automatic 4-month extension will run concurrently with the extension of time to file granted pursuant to § 1.6081–5.

(2) *Manner for submitting an application.* An application must be submitted—

(i) On Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return; or

(ii) In any other manner as may be prescribed by the Commissioner.

(3) *Time and place for filing application.* Except in the case of an individual described in § 1.6081–5(a)(5) or (6), the application must be filed on or before the date prescribed for filing the individual income tax return. In the case of an individual described in § 1.6081–5(a)(5) or (6), the application must be filed on or before the expiration of the extension of time to file granted pursuant to § 1.6081–5. The application must be filed with the Internal Revenue Service office designated in the application's instructions.

(4) *Proper estimate of tax.* An application for extension must show the full amount properly estimated as tax for the taxable year.

(5) *Coordination with § 1.6081–1.* Except in undue hardship cases, no extension of time for filing an individual income tax return will be granted under § 1.6081–1 until an automatic extension has been allowed pursuant to the provisions of this paragraph (a).

* * * * *

(c) *Termination of automatic extension.* The district director, including the Assistant Commissioner (International), or the director of a service center may terminate at any time an automatic extension by mailing to the taxpayer a notice of termination. The notice must be mailed at least 10 days prior to the termination date designated in such notice. The notice of termination must be mailed to the taxpayer at the address shown on Form 4868 or to the taxpayer's last known address.

(d) *Penalties.* See section 6651 for failure to file an individual income tax return or failure to pay the amount shown as tax on the return. In particular, see § 301.6651–1(c)(3) of this chapter (relating to a presumption of reasonable cause in certain circumstances involving an automatic extension of time for filing an individual income tax return).

(e) *Effective date.* This section is effective for applications for an automatic extension of time to file an individual income tax return filed on or after December 31, 1996.

§ 1.6081–4T [Removed]

Par. 6. Section 1.6081–4T is removed.

Par. 7. Section 1.6081–6 is added under the undesignated centerheading ''Extension of Time for Filing Returns'' to read as follows:

§ 1.6081–6 Automatic extension of time to file trust income tax return.

(a) *In general.* A trust required to file an income tax return on Form 1041, U.S. Income Tax Return for Estates and Trusts, for any taxable year will be allowed an automatic 3-month extension of time to file the return after the date prescribed for filing the return if an application under this section is filed in accordance with paragraph (b) of this section.

(b) *Requirements*. To satisfy this paragraph (b), an application for an automatic extension under this section must—

(1) Be submitted on Form 8736, Application for Automatic Extension of Time To File U.S. Return for a Partnership, REMIC or for Certain Trusts, or in

any other manner as may be prescribed by the Commissioner;

(2) Be filed on or before the date prescribed for filing the trust income tax return with the Internal Revenue Service office designated in the application's instructions; and

(3) Show the full amount properly estimated as tax for the trust for the taxable year.

(c) *Effect of extension on beneficiary.* An automatic extension of time to file a trust income tax return under this section will not operate to extend the time for filing the income tax return of a beneficiary of the trust or the time for the payment of any tax due on the beneficiary's income tax return.

(d) *Termination of automatic extension.* The district director, including the Assistant Commissioner (International), or the director of a service center may terminate at any time an automatic extension by mailing to the trust a notice of termination. The notice must be mailed at least 10 days prior to the termination date designated in such notice. The notice of termination must be mailed to the address shown on Form 8736 or to the trust's last known address.

(e) *Penalties.* See section 6651 for failure to file a trust income tax return or failure to pay the amount shown as tax on the return.

(f) *Coordination with § 1.6081–1.* Except in undue hardship cases, no extension of time for filing a trust income tax return will be granted under § 1.6081–1 until an automatic extension has been allowed pursuant to the provisions of this section.

(g) *Effective date.* This section is effective for applications for an automatic extension of time to file a trust income tax return filed on or after December 31, 1996.

Par. 8. Section 1.6081–7 is added under the undesignated centerheading ''Extension of Time for Filing Returns'' to read as follows:

§ 1.6081–7 Automatic extension of time to file Real Estate Mortgage Investment Conduit (REMIC) income tax return.

(a) *In general.* A Real Estate Mortgage Investment Conduit (REMIC) required to file an income tax return on Form 1066, U.S. Real Estate Mortgage Investment Conduit Income Tax Return, for any taxable year will be allowed an automatic 3-month extension of time to file the return after the date prescribed for filing the return if an application under this section is filed in accordance with paragraph (b) of this section.

(b) *Requirements.* To satisfy this paragraph (b), an application for an automatic extension under this section must—

(1) Be submitted on Form 8736, Application for Automatic Extension of Time To File U.S. Return for a Partnership, REMIC or for Certain Trusts, or in any other manner as may be prescribed by the Commissioner;

(2) Be filed on or before the date prescribed for filing the REMIC income tax return with the Internal Revenue Service office designated in the application's instructions; and

(3) Show the full amount properly estimated as tax for the REMIC for the taxable year.

(c) *Effect of extension on residual or regular interest holders.* An automatic extension of time to file a REMIC income tax return under this section will not operate to extend the time for filing the income tax return of a residual or regular interest holder of the REMIC or the time for the payment of any tax due on the residual or regular interest holder's income tax return.

(d) *Termination of automatic extension.* The district director, including the Assistant Commissioner (International), or the director of a service center may terminate at any time an automatic extension by mailing to the REMIC a notice of termination. The notice must be mailed at least 10 days prior to the termination date designated in such notice. The notice of termination must be mailed to the address shown on Form 8736 or to the REMIC's last known address.

(e) *Penalties.* See sections 6698 and 6651 for failure to file a REMIC income tax return or failure to pay the amount shown as tax on the return.

(f) *Coordination with § 1.6081–1.* Except in undue hardship cases, no extension of time for filing a REMIC income tax return will be granted under § 1.6081–1 until an automatic extension has been allowed pursuant to the provisions of this section.

(g) *Effective date.* This section is effective for applications for an automatic extension of time to file a REMIC income tax return filed on or after December 31, 1996.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 9. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805. * * *

Par. 10. Section 301.6651–1 is amended by revising paragraph (c)(3) to read as follows:

§ 301.6651–1 Failure to file tax return or to pay tax.

* * * * *

(c) * * *

(3) If, for a taxable year ending on or after December 31, 1995, an individual taxpayer satisfies the requirement of § 1.6081–4(a) of this chapter (relating to automatic extension of time for filing an individual income tax return), reasonable cause will be presumed, for the period of the extension of time to file, with respect to any underpayment of tax if—

(i) The excess of the amount of tax shown on the individual income tax return over the amount of tax paid on or before the regular due date of the return (by virtue of tax withheld by the employer, estimated tax payments, and any payment with an application for extension of time to file pursuant to § 1.6081–4 of this chapter) is no greater than 10 percent of the amount of tax shown on the individual income tax return; and

(ii) Any balance due shown on the individual income tax return is remitted with the return.

* * * * *

§ 301.6651–1T [Removed]

Par. 11. Section 301.6651–1T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 12. The authority citation for part 602 continues to read as follow:

Authority: 26 U.S.C. 7805.

Par. 13. In § 602.101, paragraph (c) is amended by removing the entries for § § 1.6081–2T, 1.6081–3T, and 1.6081–4T from the table, revising the entry for § 1.6081–4, and adding the following entries in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.6081–2	1545–0148 1545–1054 1545–1036
* * * * *	

CFR part or section where identified and described	Current OMB control No.
1.6081–4	1545–0188 1545–1479
1.6081–6	1545–0148 1545–1054
1.6081–7	1545–0148 1545–1054
* * * * *	

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved December 17, 1996.

Donald C. Lubick,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 29, 1996, and published in the issue of the Federal Register for December 31, 1996, 61 F.R. 69027)

Part III. Administrative, Procedural, and Miscellaneous

Low-Income Housing Tax Credit—1997 Calendar Year Resident Population Estimates

Notice 97–14

This notice informs (1) state and local housing credit agencies that allocate low-income housing tax credits under § 42 of the Internal Revenue Code and (2) states and other issuers of tax-exempt private activity bonds under § 141, of the proper population figures to be used for calculating the 1997 calendar year population-based component of the state housing credit ceiling (Credit Ceiling) under § 42(h)(3)(C)(i) and the 1997 calendar year volume cap (Volume Cap) under § 146.

The population figures both for the population-based component of the Credit Ceiling and for the Volume Cap are determined by reference to § 146(j). That section provides generally that determinations of population for any calendar year are made on the basis of the most recent census estimate of the resident population of a state (or issuing authority) released by the Bureau of the Census before the beginning of such calendar year.

The proper population figures for calculating the Credit Ceiling and the Volume Cap for the 1997 calendar year are the estimates of the resident population of states for July 1, 1996, released by the Bureau of the Census on December 30, 1996, in press release CB 96–224. For convenience, these estimates are reprinted below.

Resident Population Estimates for July 1, 1996

State	Population
Alabama	4,273,000
Alaska	607,000
Arizona	4,428,000
Arkansas	2,510,000
California	31,878,000
Colorado	3,823,000
Connecticut	3,274,000
Delaware	725,000
D.C.	543,000
Florida	14,400,000
Georgia	7,353,000
Hawaii	1,184,000
Idaho	1,189,000
Illinois	11,847,000
Indiana	5,841,000
Iowa	2,852,000
Kansas	2,572,000
Kentucky	3,884,000
Louisiana	4,351,000
Maine	1,243,000
Maryland	5,072,000
Massachusetts	6,092,000
Michigan	9,594,000
Minnesota	4,658,000
Mississippi	2,716,000
Missouri	5,359,000
Montana	879,000
Nebraska	1,652,000
Nevada	1,603,000
New Hampshire	1,162,000
New Jersey	7,988,000
New Mexico	1,713,000
New York	18,185,000
North Carolina	7,323,000
North Dakota	644,000
Ohio	11,173,000
Oklahoma	3,301,000
Oregon	3,204,000
Pennsylvania	12,056,000
Rhode Island	990,000
South Carolina	3,699,000
South Dakota	732,000
Tennessee	5,320,000
Texas	19,128,000
Utah	2,000,000
Vermont	589,000
Virginia	6,675,000
Washington	5,533,000
West Virginia	1,826,000
Wisconsin	5,160,000
Wyoming	481,000

The principal authors of this notice are Christopher J. Wilson of the Office of Assistant Chief Counsel (Passthroughs and Special Industries) and Timothy L. Jones of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this notice contact Mr. Wilson on (202) 622–3040 (not a toll-free call).

Deposits of Excise Taxes

Notice 97–15

The Internal Revenue Service will issue regulations amending the deposit requirements under the Excise Tax Procedural Regulations to limit the availability of the look-back quarter safe harbor in cases where a new excise tax is enacted or an expired excise tax is reinstated.

Section 40.6302(c)–1(c)(2) currently provides, generally, that a person can satisfy excise tax deposit obligations for a calendar quarter by depositing an amount equal to the person's excise tax liability for the second preceding quarter (the look-back quarter). For this purpose, the tax liability for the look-back quarter must be computed at current rates, but the safe harbor does not specifically address the effect of the enactment of a new tax law or the reinstatement of an expired tax.

In 1996, the aviation excise taxes, which expired on December 31, 1995, were reinstated for the period from August 27 through December 31, 1996. Because the taxes were not in effect during the first and second quarters of 1996, airlines relying on the safe harbor have deposited very little of the air transportation taxes they collected in 1996.

The Service believes such a delay is inconsistent with the overall policy and structure of the excise tax deposit rules. Accordingly, the Service will modify the look-back safe harbor to prevent similar delays with respect to future tax law changes.

The new regulations will provide that the safe harbor based on look-back quarter liability will not apply to deposits of a tax that was not in effect throughout the look-back quarter. The revised regulations will apply to liabilities attributable to tax law changes after February 10, 1997. Persons required to remit air transportation taxes for the first quarter of 1997 will satisfy their deposit obligation for amounts billed or tickets sold in December 1996 if they deposit their look-back quarter safe harbor amount in accordance with current regulations.

The principal author of this notice is Ruth Hoffman, Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Ruth Hoffman on (202) 622–3130 (not a toll-free number).

Part IV. Item of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Credit for Increasing Research Activities

REG–209494–90

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations under section 41 of the Internal Revenue Code of 1986 describing when computer software which is developed by (or for the benefit of) a taxpayer primarily for the taxpayer's internal use can qualify for the credit for increasing research activities. The proposed regulations reflect a change to section 41 made by the Tax Reform Act of 1986. This document also provides notice of a public hearing on these proposed regulations.

DATES: Comments and outlines of topics to be discussed at the public hearing scheduled for May 13, 1997 must be received by April 22, 1997.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–209494–90), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–209494–90), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the ''Tax Regs'' option of the IRS Home Page, or by submitting comments directly to the IRS Internet site at: http://www.irs.ustreas.gov/prod/tax_regs/comments.html. The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Lisa J. Shuman or Robert B. Hanson, 202–622–3120; concerning submissions and the hearing, Christina Vasquez, 202–622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 41 of the Internal Revenue Code provides a credit against tax for increasing research activities. Eligibility for the credit is determined in part on the definition of *qualified research* under section 41(d)(1). Section 231 of the Tax Reform Act of 1986 (the 1986 Act), 1986–3 C.B. 1, 87, established a new definition of *qualified research* for purposes of the research credit. Qualified research was narrowed to require that research be undertaken for the purpose of discovering information that is technological in nature and the application of which is intended to be useful in developing a new or improved business component of the taxpayer. In addition, research is eligible for the credit only if substantially all of the activities of the research constitute elements of a process of experimentation for a new or improved function, performance, or reliability or quality. Treasury and the IRS request comments on the appropriate explanation of the terms used in the definition of qualified research under the 1986 Act, in particular, the term *process of experimentation*.

Section 231 of the 1986 Act also specified that expenditures incurred in certain research, research-related, and non-research activities are to be excluded from eligibility for the credit without reference to the general requirements for credit eligibility. Under section 41(d)(4)(E) of the Code, except to the extent provided in regulations, qualified research does not include research with respect to computer software developed by (or for the benefit of) the taxpayer primarily for the taxpayer's own use (internal-use software), other than for use in (1) an activity which constitutes qualified research, or (2) a production process whose development meets the requirements in section 41(d)(1) for qualified research (as where the taxpayer is developing robotics and software for the robotics for use in operating a manufacturing process, and the taxpayer's research costs of developing the robotics are eligible for the credit).

The legislative history indicates that Congress intended to limit the credit for the costs of developing internal-use software to software meeting a high threshold of innovation. In particular, Congress intended that regulations would permit internal-use software to qualify for the credit only if, in addition to satisfying the general requirements for credit eligibility, the taxpayer can establish that the following three-part test is satisfied: the software is innovative (as where the software results in a reduction in cost, or improvement in speed, that is substantial and economically significant); the software development involves significant risk (as where the taxpayer commits substantial resources to the development of the software and there is substantial uncertainty, because of technical risk, that such resources would not be recovered in a reasonable period of time); and the software is not commercially available for use by the taxpayer (as where the software cannot be purchased, leased, or licensed and used for the intended purpose without modifications that would satisfy the first two requirements). See H.R. Rep. No. 841, 99th Cong., 2d Sess. II–73. Thus, Congress did not intend that the three-part test in the legislative history would apply in lieu of the general requirements for credit eligibility but, rather, intended that the general requirements for credit eligibility of section 41(d) also would have to be satisfied. See H.R. Rep. No. 841 at II–73.

The legislative history indicates, however, that Congress did not intend the internal-use software exclusion in section 41(d)(4)(E) to apply to research related to the development of a new or improved package of software and hardware developed as a single product of which the software is an integral part, and that is used directly by the taxpayer in providing technological services to customers in its trade or business (as where a taxpayer develops together a new or improved high technology medical or industrial instrument containing software that processes and displays data received by the instrument, or where a telecommunications company develops a package of new or improved switching equipment plus software to operate the switches). See H.R. Rep. No. 841 at II–74.

Congress intended that regulations incorporating the three-part test in the legislative history as an exception to the exclusion from the definition of qualified research under section 41(d)(4)(E) would be effective on the same date section 41(d)(4)(E) became effective. In Notice 87–12 (1987–1 C.B. 432), the IRS stated that regulations to be issued under section 41(d)(4)(E) would be effective for taxable years beginning after December 31, 1985.

Explanation of Provisions

The proposed regulations follow the legislative history and provide that internal-use software that meets the general requirements of section 41(d), is innovative, involves significant economic risk, and is not commercially available for use by the taxpayer is not excluded from eligibility for the research credit under section 41(d)(4)(E). Under the proposed regulations, this is a facts and circumstances test. Treasury and the IRS request comments on facts and circumstances, other than those factors enumerated in the legislative history, to be considered in determining whether internal-use software satisfies the three-part test.

Proposed Effective Dates

The amendments are proposed to be effective for taxable years beginning after December 31, 1985.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely (in the manner described in the ADDRESSES portion of this preamble) to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for May 13, 1997, at 10 a.m. in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit (in the manner described in the ADDRESSES portion of this preamble) comments and an outline of the topics to be discussed and the time to be devoted to each topic by April 22, 1997.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805. * * *

Section 1.41–4 also issued under 26 U.S.C. 41(d)(4)(E). * * *

Par. 2. Section 1.41–0 is amended by revising the entry for § 1.41–4 to read as follows:

§ 1.41–0 Table of contents.

* * * * *

§ 1.41–4 Qualified research for taxable years beginning after December 31, 1985.

(a) through (d) [Reserved].
(e) Internal-use computer software.
(1) General rule.
(2) Requirements.
(3) Computer software and hardware developed as a single product.
(4) Primarily for internal use.
(5) Special rule.
(6) Application of special rule.
(7) Effective date.

* * * * *

Par. 3. Section 1.41–4 is revised to read as follows:

§ 1.41–4 Qualified research for taxable years beginning after December 31, 1985.

(a) through (d) [Reserved].

(e) *Internal-use computer software*—(1) *General rule.* Research with respect to computer software that is developed by (or for the benefit of) the taxpayer primarily for the taxpayer's internal use is eligible for the research credit only if the software satisfies the requirements of paragraph (e)(2) of this section. Generally, research with respect to computer software is not eligible for the research credit where software is used internally, for example, in general and administrative functions (such as payroll, bookkeeping, or personnel management) or in providing noncomputer services (such as accounting, consulting, or banking services).

(2) *Requirements.* The requirements of this paragraph (e)(2) are—

(i) The software satisfies the requirements of section 41(d)(1);

(ii) The software is not otherwise excluded under section 41(d)(4) (other than section 41(d)(4)(E)); and

(iii) One of the following conditions is met—

(A) The taxpayer uses the software in an activity that constitutes qualified research (other than the development of the internal-use software itself);

(B) The taxpayer uses the software in a production process that meets the requirements of section 41(d)(1); or

(C) The software satisfies the special rule of paragraph (e)(5) of this section.

(3) *Computer software and hardware developed as a single product.* This paragraph (e) does not apply to the development costs of a new or improved package of computer software and hardware developed together by the taxpayer as a single product, of which the software is an integral part, that is used directly by the taxpayer in providing technological services in its trade or business to customers. In these cases, eligibility for the research credit is to be determined by examining the combined hardware-software product as a single product.

(4) *Primarily for internal use.* All relevant facts and circumstances are to be considered in determining if computer software is developed primarily for the taxpayer's internal use. If computer software is developed primarily for the taxpayer's internal use, the requirements of this paragraph (e) apply even though the taxpayer intends to, or subsequently does, sell, lease, or license the computer software.

(5) *Special rule.* Computer software satisfies the special rule of this para-

graph (e)(5) only if the taxpayer can establish that—

(i) The software is innovative (as where the software results in a reduction in cost, or improvement in speed, that is substantial and economically significant);

(ii) The software development involves significant economic risk (as where the taxpayer commits substantial resources to the development and there is a substantial uncertainty, because of technical risk, that such resources would be recovered within a reasonable period); and

(iii) The software is not commercially available for use by the taxpayer (as where the software cannot be purchased, leased, or licensed and used for the intended purpose without modifications that would satisfy the requirements of paragraphs (e)(5)(i) and (ii) of this section).

(6) *Application of special rule.* In determining if the special rule of paragraph (e)(5) of this section is satisfied all of the facts and circumstances are considered. The special rule allows the costs of developing internal-use software to be eligible for the research credit only if the software meets a high threshold of innovation. The facts and circumstances analysis takes into account only the results attributable to the development of the new or improved software independent of the effect of any modifications to related hardware or other software. The weight given to any fact or circumstance will depend on the particular case.

(7) *Effective date.* This paragraph (e) is applicable for taxable years beginning after December 31, 1985.

§§ 1.41–0A through 1.41–8A [Removed]

Par. 4. Sections 1.41–0A through 1.41–8A and the undesignated centerheading preceding these sections are removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 5. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 6. In § 602.101, paragraph (c) is amended by removing the following entries from the table:

§ 602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.41–4A.	1545–0074
1.41–4(b) and (c)	1545–0074
* * * * *	

Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 31, 1996, 8:45 a.m., and published in the issue of the Federal Register for January 2, 1997, 62 F.R. 81)

Notice of Proposed Rulemaking and Notice of Public Hearing

Determination of Earned Premiums

REG–209839–96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the requirement that insurance companies other than life insurance companies reduce by 20 percent their deductions for increases in unearned premiums. This requirement was enacted as part of the Tax Reform Act of 1986. These regulations are necessary in order to provide guidance to nonlife insurance companies that are subject to the 20 percent reduction rule. This document also contains a notice of a public hearing on the proposed regulations.

DATES: Written comments must be received by April 2, 1997. Requests to speak and outlines of oral comments to be discussed at the public hearing scheduled for April 30, 1997 at 10:00 a.m. must be received by April 2, 1997.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–209839–96), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R REG–209839–96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the internet by selecting the ''Tax Regs'' option on the IRS Home Page, or by submitting comments directly to the IRS internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html. The public hearing will be held in the Auditorium, Internal Revenue Service Building, 1111 Constitution Avenue NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Gary Geisler, (202) 622–3970; concerning submissions and the hearing, Evangelista Lee, (202) 622–7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

A nonlife insurance company's underwriting income equals its premiums earned on insurance contracts during the taxable year less its losses incurred and its expenses incurred. For taxable years beginning on or after January 1, 1993, a company's premiums earned on insurance contracts during the taxable year is an amount equal to the gross premiums written on insurance contracts during the taxable year, less return premiums and premiums paid for reinsurance, plus 80 percent of unearned premiums at the end of the prior taxable year, less 80 percent of unearned premiums at the end of the current taxable year.

The gross premiums written for an insurance or reinsurance contract is the total amount charged by the insurance company for the insurance coverage provided under the contract, including amounts charged covering the company's expenses and overhead. Written premiums are generally recorded for the full term of coverage for the year in which the contract is issued. Upon recording a written premium, the company establishes an unearned premium liability to reflect the portion of the written premium which relates to the unexpired portion of the insurance coverage.

The term ''unearned premium'' historically referred to the portion of the gross premiums written that would have to be returned to the policyholder upon cancellation of the policy and that was in direct proportion to the unexpired term of the policy. *See, e.g., Buckeye Union Casualty Co. v. Commissioner*, 448 F.2d 228, 230 (6th Cir. 1971), *aff'g* 54 T.C. 13, 20 n.5 (1970). Cases and rulings expanded this definition to include premiums paid for a future benefit, the cost of which was fixed when

the policy was issued. *See, e.g., Massachusetts Protective Ass'n. v. United States*, 114 F.2d 304 (1st Cir. 1940); *C.P.A. Co. v. Commissioner*, 7 T.C. 912 (1946) (nonlife company), acq. 1947–1 C.B. 1; Rev. Rul. 55–705, 1955–2 C.B. 280. *But cf. Bituminous Casualty Corp. v. Commissioner*, 57 T.C. 58 (1971), *acq. in result* 1973–2 C.B. 1 (stating in dictum that ''unearned premiums'' had a substantially broader definition than the one developed in the cases and rulings cited above).

Prior to 1987, the increase in unearned premiums during the taxable year was deducted from gross premiums written in the computation of premiums earned. For example, if a company on September 1st issued a one-year fire insurance policy with a premium of $1,200, the company on that date would record a gross written premium of $1,200 and establish a $1,200 unearned premium reserve. On December 31st, the company would have earned one-third of the premium, $400, but would have an $800 unearned premium reserve liability for the remaining eight months of coverage to be provided in periods after the close of the taxable year. The subtraction of the full amount of unearned premiums from the gross written premium ''generally reflect[ed]'' the accounting conventions (often referred to as ''statutory accounting principles'') used to prepare the annual statement for state insurance regulatory purposes. 2 H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. II–354 (1986), 1986–3 C.B. (Vol. 4) 354; S. Rep. No. 313, 99th Cong., 2d Sess. 495 (1986), 1986–3 C.B. (Vol. 3) 495; H.R. Rep. No. 426, 99th Cong., 1st Sess. 668 (1985), 1986–3 C.B. (Vol. 2) 668.

A nonlife company generally deducts expenses incurred in the taxable year in which the expenses are reported on the company's annual statement. These expenses include premium acquisition expenses attributable to unearned premiums.

In 1986, Congress determined that the combination of deferring unearned premiums and currently deducting premium acquisition expenses attributable to unearned premiums under the accounting conventions used to prepare a nonlife insurance company's annual statement resulted in a mismatch of income and expense. Congress decided to require a better measurement of income for Federal income tax purposes. H.R. Rep. No. 426, 1986–3 C.B. (Vol. 2) at 669; S. Rep. No. 313, 1986–3 C.B. (Vol. 3) at 496. Rather than require a nonlife company to capitalize and amortize premium acquisition expenses, Congress reduced by 20 percent the current deduction for unearned premiums. See section 832(b)(4)(B); 2 H.R. Conf. Rep. No. 841, 1986–3 C.B. (Vol. 4) at 354–55; S. Rep. No. 313, 1986–3 C.B. (Vol. 3) at 495–98; H.R. Rep. No. 426, 1986–3 C.B. (Vol. 2) at 668–70. This reduction in unearned premiums is sometimes referred to as the ''20 percent haircut.'' The acceleration of income as a result of the 20 percent haircut is intended to be roughly equivalent to denying current deductibility for a portion of the premium acquisition expenses.

Congress intended the 20 percent haircut to apply to all amounts (other than life insurance reserves and title insurance reserves) that were considered unearned premiums for Federal income tax purposes as of 1986. The House Report states that ''[a]ll items which are included in unearned premiums under section 832(b) of present law are subject to this reduction in the deduction.'' H.R. Rep. No. 426, 1986–3 C.B. (Vol. 2) at 669. In describing the House bill, the Conference Report reiterates that ''[a]ll items which are included in unearned premiums under section 832(b) of present law are subject to this reduction in the deduction'' and describes the Senate amendment as ''the same as the House bill, except that life insurance reserves which are included in unearned premium reserves under section 832(b)(4) are not subject to this reduction.'' 2 H.R. Conf. Rep. No. 841, 1986–3 C.B. (Vol. 4) at 354–55. The Report's description of the Conference agreement states that the agreement ''follows the Senate amendment'' but ''provides special treatment of title insurance unearned premium reserves.'' *Id.* See sections 832(b)(7) and (8) for the rules applicable to life insurance and title insurance reserves.

Following the imposition of the 20 percent haircut on unearned premiums, the National Association of Insurance Commissioners (NAIC) revised the statutory accounting principles used to prepare a nonlife insurance company's annual statement. In general, these changes permitted a nonlife company to defer recording written premiums and/or to reduce the amount of unearned premiums reported on the company's annual statement. The affected items included advance premiums, additional premiums on retrospectively rated insurance policies, and the reporting of written premiums for workers' compensation policies and certain other casualty policies where the covered risk varies over the policy term.

Prior to 1989, advance premiums were required to be reported in written premiums and unearned premiums on the annual statement for the year in which the advance premiums were received. However, statutory accounting principles now permit advance premiums to be accumulated in a suspense account and reported as a write-in liability on the annual statement. A company electing to use this alternative treatment would not report advance premiums in either written premiums or unearned premiums on the annual statement until the effective date of the underlying coverage.

Statutory accounting principles also required a nonlife insurance company to record an estimated liability for payment of return premiums under retrospectively rated insurance policies (retro credits) as part of the unearned premium liability. Estimates of additional premiums due from insureds under these policies (retro debits) historically were not taken into account except as an offset to the company's estimated liability for payment of retro credits. Thus, retro debits were not permitted to be shown as assets on the annual statement, and generally were not included in written premiums prior to the year in which the company billed the policyholder for these additional premiums. Beginning in 1988, however, the NAIC permitted retro debits to be shown in an insurance company's admitted assets, subject to certain limitations. The NAIC currently has under consideration a proposal that would require retro credits to be recorded as a write-in liability on the annual statement, rather than as part of unearned premiums. This proposal would also permit retro credits and retro debits to be taken into account either as adjustments to written premiums or as adjustments to earned premiums for purposes of determining underwriting income on the annual statement.

A nonlife insurance company ordinarily reports the full amount of premiums provided in a casualty insurance policy (including any deferred premium installments) in written premiums and unearned premiums for the year in which the policy is issued. However, for workers' compensation policies and certain other casualty policies where the covered risk varies over the policy term, some but not all state insurance regulators permit written premiums to be

recorded based on installment billings to the policyholder. If the insurance company issues these policies throughout the year, and the premiums for the policies are billed monthly, the portion of the total written premiums that would be shown as unearned premiums is substantially smaller than would be the case if the written premiums and unearned premiums were determined based on the entire policy term. The NAIC currently has under consideration proposed guidance that would require the full amount of the premiums provided in all casualty insurance policies to be reported in written premiums and unearned premiums on the effective date of the related coverage.

Section 832(b)(1)(A) provides that a nonlife insurance company's income is computed on the basis of the underwriting and investment exhibit of the annual statement approved by the NAIC. Some companies assert that section 832(b)(1)(A) limits application of the 20 percent haircut to the amount of unearned premiums reported on the annual statement. Under this approach, a company that elects for annual statement purposes to report advance premiums as a write-in liability, to offset unearned premiums by retro debits, or to include deferred premiums on policies covering fluctuating risks in written premiums only when billed to the insured, reduces the amount of unearned premiums subject to the 20 percent haircut.

The existing regulations under § 1.832–4(a)(2) state that ''[t]he underwriting and investment exhibit[,] . . . insofar as it is not inconsistent with the provisions of the Code will be recognized and used as a basis for [computing the net income of a nonlife insurance company].'' However, the regulations recognize that not all items of the exhibit ''reflect . . . income as defined in the Code.'' Where statutory accounting principles permit a company to elect among alternative accounting practices, one or more of which do not clearly reflect income as defined by the Code, the company is required for Federal tax purposes to use a method that clearly reflects income. Section 446(b) and § 1.446–1(a)(2). Furthermore, an accounting practice used on the annual statement, although specifically mandated by statutory accounting principles, is not used for purposes of computing taxable income if that practice is inconsistent with the Code.

Overview of Proposed Regulations

The proposed regulations define gross premiums written, return premiums, and unearned premiums for tax purposes. The proposed regulations also provide rules for determining when gross premiums written, return premiums, and unearned premiums are taken into account for tax purposes. In this manner, the proposed regulations ensure that items such as advance premiums and retrospective premium adjustments are treated consistently for purposes of the 20 percent haircut on unearned premiums.

Explanation of Provisions

The starting point for determining a nonlife insurance company's premiums earned for tax purposes is the ''gross premiums written on insurance contracts during the taxable year.'' Proposed § 1.832–4(a)(4)(i) defines ''gross premiums written on insurance contracts'' as the total amounts charged by the insurance company for insurance coverage under insurance or reinsurance contracts issued or renewed during the taxable year. Thus, ''gross premiums written'' includes collected and uncollected premiums.

Proposed § 1.832–4(a)(4)(ii) addresses the treatment of retro debits, which reflect estimates of additional premiums to be received from the insured or the reinsured based on the insurance company's loss experience during expired coverage periods. Thus, retro debits represent additional gross premiums written rather than offsets to the unearned premium liability for unexpired coverage periods. Treating retro debits as offsets to unearned premiums would reduce the acceleration of income under the 20 percent haircut, and would allow some companies with retro debits exceeding their unearned premiums to report a lesser amount of earned premiums for Federal income tax purposes than for annual statement reporting purposes. This result is contrary to the Congressional intent to accelerate the rate at which premiums are earned for tax purposes in order to correct the mismatching of income and expenses on the annual statement. Accordingly, proposed § 1.832–4(a)(4)(ii) requires retro debits to be included in gross premiums written regardless of the manner in which the retro debits are reported on the underwriting exhibit of the annual statement.

Under section 832(b)(4)(A), an insurance company reduces the amount of gross premiums written on insurance contracts during the taxable year by return premiums and premiums paid for reinsurance. Proposed § 1.832–4(a)(5)(i) defines return premiums as amounts paid or credited to the policyholder in accordance with the terms of an insurance contract, other than policyholder dividends or claims and benefit payments. Thus, return premiums include amounts paid or credited to the policyholder with respect to endorsements and modifications of the terms of coverage of an insurance contract. Return premiums also include amounts returned or credited to the policyholder on cancellation of an insurance contract, including the unearned portion of any deferred or uncollected premiums previously included by the company in gross premiums written and unearned premiums. Finally, return premiums include amounts contractually required to be returned to the ceding company under a reinsurance contract.

The proposed regulations modify the treatment of retro credits under existing law for purposes of determining earned premiums. Since 1943, § 1.832–4(a)(3)(ii) has provided that the liability for return premiums under a retrospectively rated policy is included in a nonlife company's unearned premiums for tax purposes. Although retro credits were included in unearned premiums in 1986, these amounts are based on an insured's loss experience during expired coverage periods, for which the company has already earned the premium. For this reason, proposed § 1.832–4(a)(5)(ii) provides that a nonlife company's provision for payment of a retro credit generally is included in return premiums that reduce gross premiums written. However, proposed § 1.832–4(a)(6)(iv) gives a company the option to include retro credits in unearned premiums to which the 20 percent haircut applies.

The proposed regulations provide timing rules with respect to when a company reports gross premiums written and unearned premiums for tax purposes. Proposed § 1.832–4(a)(7) requires a company to report gross premiums written with respect to an insurance or reinsurance contract for the earlier of the taxable year which includes the effective date of the contract or the taxable year in which all or a part of the gross premium for the contract is received. Thus, the company must report

gross premiums written with respect to an insurance contract for the year in which it collects an advance premium. By requiring advance premiums to be included in gross premiums written and unearned premiums, regardless of the manner in which the advance premiums are recorded on the annual statement, the proposed regulations ensure that the treatment of a nonlife insurance company's advance premiums conforms with the treatment of advance premiums of a life insurance company under section 807(e)(7).

The NAIC is considering proposed guidance that would require the premium for the entire term of a property and casualty insurance contract to be recorded as written premium on the effective date of the contract. The proposed NAIC guidance rejects the previous NAIC position that permitted written premiums for workers' compensation policies and certain other casualty policies where the covered risk varies over the policy term to be recorded when billed. For this reason, the method of reporting gross premiums written for workers' compensation policies and certain other casualty insurance policies covering fluctuating risks is reserved in the proposed regulations.

Proposed Effective Date

The proposed regulations are proposed to apply to the determination of premiums earned for insurance contracts issued or renewed in taxable years beginning after the date on which final regulations are published in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entitles, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and 8 copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Wednesday, April 30, 1997 in the Auditorium, Internal Revenue Service Building, 1111 Constitution Avenue NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments by April 2, 1997 and submit an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and 8 copies) by April 2, 1997.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of this regulation is Gary Geisler, Office of Assistant Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2 Section 1.832–4 is amended as follows:

1. Paragraph (a)(3) is revised.

2. Paragraphs (a)(4) and (a)(5) are redesignated as (a)(9) and (a)(10).

3. New paragraphs (a)(4) through (a)(8) are added.

The additions and revisions read as follows:

§ 1.832–4 Gross income.

(a) * * *

(3) *Premiums earned.* The determination of premiums earned on insurance contracts during the taxable year begins with the insurance company's gross premiums written on insurance contracts during the taxable year, reduced by return premiums and ceded reinsurance premiums. Subject to the exceptions in sections 832(b)(7), 832(b)(8), and 833(a)(3), this amount is increased by 80 percent of the unearned premiums at the end of the preceding taxable year, and is decreased by 80 percent of the unearned premiums at the end of the taxable year.

(4) *Gross premiums written*—(i) *In general.* An insurance company's ''gross premiums written on insurance contracts during the taxable year'' are the total amounts charged by the insurance company for insurance coverage under insurance or reinsurance contracts issued or renewed by the company during the taxable year.

(ii) *Debits on retrospectively rated insurance policies.* Gross premiums written include an insurance company's estimate of the gross additional premiums to be received from the insured or the reinsured with respect to the expired portion of a retrospectively rated insurance or reinsurance contract (retro debits). The retro debits are reported for the taxable year in which the amounts can be reasonably estimated based on information used to compute the insurance company's loss reserves. An insurance company adjusts gross premiums written to reflect payments from the insured or the reinsured with respect to retro debits, as well as changes in the estimate of retro debits.

(5) *Return premiums*—(i) *In general.* Return premiums are amounts paid or credited to the policyholder in accordance with the terms of an insurance contract, other than policyholder dividends or claims and benefit payments. For example, return premiums include amounts returned or credited to the policyholder based on modifications of the terms of an insurance contract. Return premiums also include amounts contractually required to be returned to the ceding company pursuant to a reinsurance contract.

(ii) *Credits on retrospectively rated insurance policies.* Except as provided in paragraph (a)(6)(iv) of this section, return premiums include an insurance company's estimate of the gross liability

for return premiums to be paid or credited to the insured or the reinsured with respect to the expired portion of a retrospectively rated insurance or reinsurance contract (retro credits). The retro credits are included in return premiums for the taxable year in which the insurance company's liability to pay or credit these amounts can be reasonably estimated based on information used to compute the company's loss reserves. An insurance company adjusts return premiums to reflect payments made or amounts credited to the insured or the reinsured with respect to retro credits, as well as changes in the estimate of retro credits.

(iii) *Unpaid premiums on cancelled policies.* If an insurance contract is cancelled, an insurance company includes in return premiums the unearned portion of any deferred or uncollected premiums previously included in gross premiums written and unearned premiums.

(6) *Unearned premiums*—(i) *In general.* The unearned premium for an insurance or reinsurance contract is the portion of the gross premiums written which is attributable to future insurance coverage to be provided under the contract. An insurance company makes an appropriate adjustment to its unearned premiums for an insurance or reinsurance contract if the contract is reinsured with, or retroceded to, another insurance company.

(ii) *Special rules.* In computing ''premiums earned on insurance contracts during the taxable year,'' the amount of unearned premiums includes—

(A) Life insurance reserves (as defined in section 816(b), but computed in accordance with section 807(d));

(B) In the case of a mutual flood or fire insurance company described in section 832(b)(1)(D) (with respect to contracts described in that section) the amount of unabsorbed premium deposits which the company would be obligated to return to its policyholders at the close of the taxable year if all its policies were terminated at that time;

(C) In the case of an interinsurer or reciprocal underwriter which reports unearned premiums on its annual statement net of premium acquisition expenses, the unearned premiums on the company's annual statement increased by the portion of premium acquisition expenses allocable to those unearned premiums;

(D) In the case of a title insurance company, its discounted unearned premiums (computed in accordance with section 832(b)(8)); and

(E) Amounts treated as unearned premiums pursuant to the optional treatment provided in paragraph (a)(6)(iv) of this section.

(iii) *Method of determining unearned premiums.* If the risk of loss under an insurance or reinsurance contract arises uniformly over the contract period, the unearned premium attributable to the portion of the insurance coverage which has not expired is computed on a pro rata basis. If the risk of loss does not arise uniformly over the contract period, the insurance company may consider the pattern or incidence of the risk in determining the portion of the gross premium written which is attributable to the portion of the insurance coverage which has not yet expired.

(iv) *Option to include retro credits in unearned premiums.* An insurance company may include retro credits in unearned premiums under section 832(b)(4) for its first taxable year beginning after the date on which final regulations are published in the **Federal Register**. Any company exercising this option must apply it consistently to all retro credits with respect to retrospectively rated insurance or reinsurance contracts issued or renewed during the taxable year and all subsequent years.

(7) *Method of reporting gross premiums written*—(i) *In general.* An insurance company reports gross premiums written with respect to an insurance or reinsurance contract for the earlier of the taxable year which includes the effective date of the contract or the taxable year in which all or a part of the gross premium for the contract is received.

(ii) *Method of reporting gross premiums written on policies covering fluctuating risks.* [Reserved]

(iii) *Examples.* The provisions of this paragraph (a)(7) are illustrated by the following examples:

Example 1. (i) IC is a nonlife insurance company which, pursuant to section 843, files its returns on a calendar year basis. On July 1, 1998, IC issues a fire insurance policy to A, an individual. The policy provides coverage for a one-year term beginning on July 1, 1998 and ending on June 30, 1999. The premium provided in the policy is $500, which may be paid either in full on the policy effective date or in quarterly installments of $125. A selects the installment payment option. As of December 31, 1998, the policy issued to A remains in force, and IC has collected a total of $250 of installment premiums from A. Assume IC has issued no other policies.

(ii) For the taxable year ending December 31, 1998, IC reports the $500 premium provided in A's policy in gross premiums written under section 832(b)(4)(A). IC also claims a reduction under section 832(b)(4)(B) for 80% of the $250 of unearned premiums ($200) associated with the policy at the end of the taxable year.

Example 2. (i) The facts are the same as *Example* 1, except that the term of coverage for the fire insurance policy issued to A begins on January 1, 1999 and ends on December 31, 1999. On December 15, 1998, IC receives $125 from A and agrees to apply this amount as the first premium installment due on the policy.

(ii) Under paragraph (a)(7)(i) of this section, IC reports gross premiums written for the policy issued to A for the taxable year in which the advance premium is received. Thus, for the taxable year ending December 31, 1998, IC includes $500 in its gross premiums written under section 832(b)(4)(A). IC also claims a reduction under section 832(b)(4)(B) for 80% of the $500 of unearned premiums ($400) associated with the policy at the end of the taxable year.

(8) *Effective date.* Paragraphs (a)(3) through (a)(7) of this section are applicable with respect to the determination of premiums earned for insurance contracts issued or renewed during taxable years beginning after the date on which final regulations are published in the **Federal Register**.

* * * * *

Michael P. Dolan,
Acting Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 31, 1996, 8:45 a.m., and published in the issue of the Federal Register for January 2, 1997, 62 F.R. 72)

Notice of Proposed Rulemaking and Notice of Public Hearing

Recomputation of Life Insurance Reserves

REG–246018–96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the definition of life insurance reserves. The proposed regulations permit the taxpayer or the IRS to recompute certain reserves if those reserves were initially computed or estimated on other than an actuarial basis. The proposed regulations affect both life insurance companies and property and casualty insurance companies. This document also contains a notice of a public hearing on the proposed regulations.

DATES: Written comments must be received by April 2, 1997. Requests to speak and outlines of oral comments to be discussed at the public hearing scheduled for Thursday, April 17, 1997, at 10 a.m. must be received by Thursday, March 27, 1997.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–246018–96), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–246018–96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the ''Tax Regs'' option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html. The public hearing will be held in the Commissioner's conference room, room 3313, Internal Revenue Service Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Ann Cammack, (202) 622–3970; concerning submissions and the hearing, Evangelista Lee, (202) 622–7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

To qualify as a life insurance reserve for purposes of Part I of subchapter L of the Internal Revenue Code, a reserve must satisfy various requirements, including the requirement in section 816(b)(1)(A) and § 1.801–4(a)(1) that it be ''computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interest.'' Qualifying as a life reserve under section 816(b) has various consequences. Life reserves are included in the numerator and denominator of the reserve ratio test of section 816(a), which is used to determine when an insurance company is taxed as a life insurance companyunder Part I of subchapter L. Increases in life reserves as defined in section 816(b) are taken into account under section 807(c)(1). In addition, life reserves as defined in section 816(b) are considered part of a nonlife company's unearned premiums under section 832(b)(4).

Two circuits have construed former section 801(b)(1)(A), which was recodified as section 816(b)(1)(A) in 1984, to prevent reserves held with respect to life, annuity or noncancellable accident and health policies but not computed or estimated using actuarial tables from qualifying as life reserves. The IRS also has held that life reserves must be computed or estimated using actuarial tables under former section 801(b)(1)(A). *See e.g.*, Rev. Rul. 69–302 (1969–2 C.B. 186). The Claims Court, in contrast, has concluded that the statute and regulation do not necessarily require the insurance company to compute its life reserves using actuarial tables, when a different method results in reserves that ''reasonably approximate'' actuarial reserves.

Rev. Rul. 69–302 held that not only were life reserves required to be computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interest, but that reserves for credit life insurance contracts could not be retroactively recomputed in a manner that would enable them to qualify as life reserves. Neither of the cases cited in Rev. Rul. 69–302, however, addressed the question of whether taxpayers or the Commissioner could recompute reserves based on information that was available at the end of the applicable taxable year. Two subsequent cases came to opposite conclusions on this issue.

The reserve ratio test of section 816(a) was intended to distinguish between life and nonlife insurance companies based on the nature of each company's business, as measured by its reserves. This purpose is not achieved, however, if a company that only issues life insurance, annuity or noncancellable accident and health contracts can elect to be taxed as a nonlife company by failing to use mortality and morbidity tables and assumed rates of interest in computing or estimating its reserves for some of those contracts.

Explanation of Provisions

Proposed § 1.801–4(g)(1) provides that if an insurance company does not compute or estimate its reserves for certain contracts on the basis of mortality or morbidity tables and assumed rates of interest, then the taxpayer or the Commissioner may recompute those reserves on the basis of mortality or morbidity tables and assumed rates of interest. This regulation will apply to reserves for contracts involving, at the time with respect to which the reserves are computed, life, accident or health contingencies, if such reserves were not initially computed in accordance with the requirements of section 816(b)(1)(A).

Proposed § 1.801–4(g)(2) provides that if the taxpayer or the Commissioner recomputes reserves pursuant to § 1.801–4(g)(1), the reserves satisfy the section 816(b)(1)(A) requirement that a life reserve be computed or estimated using actuarial tables and assumed rates of interest. Assuming that these amounts satisfy the other requirements of section 816(b), the recomputed amounts will be considered life insurance reserves under section 816(b), and the recomputed reserves will be included in both the numerator and the denominator of the reserve ratio test under section 816(a). In addition, the reserves for such contracts will be taken into account under section 807(c)(1) and will be used to compute a nonlife company's unearned premiums under section 832(b)(4).

Proposed § 1.801–4(g)(3) provides that for purposes of section 816(b)(4) and § 1.801–3(i), which provide that the mean of the beginning and end of year reserves will be used for purposes of section 816(a), (b) and (c), the reserves on a life insurance, annuity or noncancellable accident and health contract must be recomputed for both the beginning and the end of the year.

Proposed § 1.801–4(g)(4) requires that no information acquired after the date as of which the beginning of year reserves were initially computed or estimated may be taken into account in recomputing those reserves under paragraph (g)(1). It also requires that no information acquired after the date as of which the end of year reserves were initially computed or estimated may be taken into account in recomputing those reserves under paragraph (g)(1).

The IRS is considering whether to issue guidance under section 816, including regulations regarding the definition of ''total reserves'' under section 816(c) as well as redesignating and revising the regulations issued under prior law section 801. The IRS invites comments on this matter.

Proposed Effective Date

Proposed § 1.801–4(g) would be effective with respect to returns filed for taxable years beginning after the publication of the final regulations.

Effect on Other Documents

The IRS will modify, clarify, or obsolete publications as necessary to conform with this regulation as of the date of publication in the **Federal Register** of the final regulations. *See e.g.*, Rev. Rul. 69–302 (1969–2 C.B. 186). The IRS solicits comments as to whether other publications should be modified or obsoleted.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and 8 copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Thursday, April 17, 1997 in the Commissioner's conference room, room 3313, Internal Revenue Service Building at 10:00 a.m. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments by March 27, 1997 and submit an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and 8 copies) by March 27, 1997.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of this regulation is Ann B. Cammack, Office of Assistant Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.801–4 is amended by adding a new paragraph (g) to read as follows:

§ 1.801–4 Life insurance reserves.

* * * * *

(g) *Recomputation of life insurance reserves*—(1) *General.* If an insurance company does not compute or estimate its reserves for contracts involving, at the time with respect to which the reserves are computed, life, accident or health contingencies, on the basis of mortality or morbidity tables and assumed rates of interest, then the taxpayer or the Commissioner may recompute reserves for those contracts on the basis of mortality or morbidity tables and assumed rates of interest.

(2) *Effect of recomputation.* If reserves are recomputed pursuant to paragraph (g)(1) of this section, the recomputed reserves satisfy the requirements of section 816(b)(1)(A).

(3) *Mean reserve.* For purposes of section 816(b)(4) and § 1.801–3(i), if reserves are recomputed pursuant to paragraph (g)(1) of this section for a taxable year, the reserves must be recomputed for both the beginning and the end of the taxable year.

(4) *Subsequently acquired information.* No information acquired after the date as of which a reserve was initially computed or estimated may be taken into account in recomputing that reserve under paragraph (g)(1) of this section.

(5) *Effective date.* This section is applicable with respect to returns filed for taxable years beginning after the date final regulations are filed with the Office of the Federal Register.

Michael P. Dolan,
Acting Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 31, 1996, 8:45 a.m., and published in the issue of the Federal Register for January 2, 1997, 62 F.R. 71)

Notice of Proposed Rulemaking

Requirement of Return and Time for Filing

REG–247862–96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In T.D. 8705, page 16, the IRS is issuing regulations that provide that disqualified persons and organization managers liable for section 4958 excise taxes are required to file Form 4720. The regulations also specify the filing date for returns for the period to which the new excise taxes apply retroactively. The text of those temporary regulations also serves as the text of these proposed regulations.

DATES: Written comments must be received by April 2, 1997.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–247862–96), room 5226, Internal Revenue Service, POB 7604 Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (REG–247862–96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the ''Tax Regs'' option of the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

FOR FURTHER INFORMATION CONTACT: Phyllis Haney, (202) 622–4290 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Final and temporary regulations in T.D. 8705 amend the Foundation and

Similar Excise Taxes Regulations (26 CFR part 53) relating to sections 6011 and 6071. The final regulations contain rules relating to the requirement of a return to accompany payment of section 4958 excise taxes; the temporary regulations prescribe the time for filing that return.

The text of those temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations.

These rules were first published in Notice 96–46 (1996–39 I.R.B. 7) (September 23, 1996). The new section 4958 excise taxes were added by section 1311 of the Taxpayer Bill of Rights 2, Public Law 104–168, 110 Stat. 1452, enacted July 30, 1996.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Comments and Request for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by a person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Phyllis Haney, Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 53 is proposed to be amended as follows:

PART 53—FOUNDATION AND SIMILAR EXCISE TAXES

Paragraph 1. The authority citation for part 53 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 2. Section 53.6071–1 is amended by adding paragraph (f) to read as follows:

§ 53.6071–1 Time for filing returns.

* * * * *

(f) [The text of paragraph (f) of this section is the same as the text of § 53.6071–1T(f) published in T.D. 8705, page 16.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 31, 1996, 8:45 a.m., and published in the issue of the Federal Register for January 2, 1997, 62 F. R. 84)

Notice of Proposed Rulemaking

Miscellaneous Sections Affected by the Taxpayer Bill of Rights 2 and the Personal Responsibility and Work Opportunity Reconciliation Act of 1996

REG–248770–96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to joint returns, property exempt from levy, interest, penalties, offers in compromise, and the awarding of costs and certain fees. The proposed regulations reflect changes to the law made by the Taxpayer Bill of Rights 2 and a conforming amendment made by the Personal Responsibility and Work Opportunity Reconciliation Act of 1996. The proposed regulations affect taxpayers with respect to filing of returns, interest, penalties, court costs, and payment, deposit, and collection of taxes.

DATES: Written comments and requests for a public hearing must be received by April 2, 1997.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–248770–96), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–248770–96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Finally, taxpayers may submit comments electronically via the INTERNET by selecting the ''Tax Regs'' option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Beverly A. Baughman, (202) 622–4940 regarding joint returns and penalties; Robert A. Miller, (202) 622–3640 regarding levy; Donna J. Welch, (202) 622–4910 regarding interest; Thomas D. Moffitt, (202) 622–7900 regarding court costs; and Kevin B. Connelly, (202) 622–3640 regarding compromises (not toll-free numbers). Concerning submissions, Evangelista Lee, (202) 622–7190 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224. Comments on the collection of information should be received by March 3, 1997. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information in this proposed regulation is in § 301.7430–2(c)(3)(i)(B). This information is required to obtain an award of reasonable administrative costs. This information will be used to determine if a taxpayer is entitled to an award of reasonable administrative costs. The collection of information is required to obtain the award. The likely respondents are individuals, business or other for-profit institutions, nonprofit institutions, and small businesses or organizations.

Estimated total annual reporting burden: 10 hours.

The estimated annual burden per respondent: 15 minutes.

Estimated number of respondents: 38

Estimated annual frequency of responses: On occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains proposed amendments to the Income Tax Regulations and the Regulations on Procedure and Administration (26 CFR parts 1 and 301, respectively) relating to joint returns under section 6013, levy under section 6334, interest under section 6601, the failure to file penalty under section 6651, the failure to deposit penalty under section 6656, compromise under section 7122, and awards of costs and certain fees under section 7430. These sections were amended by the Taxpayer Bill of Rights 2 (TBOR2) (Pub. L. No. 104–168, 110 Stat. 1452 (1996)) and the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (Pub. L. No. 104–193, 110 Stat. 2105 (1996)). The changes made by TBOR2 and the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 are reflected in the proposed regulations.

Explanation of Provisions

Interest and Penalties

Section 6601 requires a taxpayer to pay interest on late payments of tax. However, sections 6601(e)(2) and 6601(e)(3) provide an interest-free period if a taxpayer pays the tax due within a certain number of days after the date of the notice and demand for payment. Sections 303(a) and 303(b)(1) of TBOR2 amended sections 6601(e)(2) and 6601(e)(3) to extend this interest-free period. Therefore, § 301.6601–1(f) of the proposed regulations extends the interest-free period from 10 days to 21 calendar days after the date of the notice and demand (10 business days if the amount for which the notice and demand is made equals or exceeds $100,000) with respect to any notice and demand made after December 31, 1996. The proposed regulations also define business day and calendar day for purposes of § 301.6601–1(f).

Section 6651(a)(3) imposes a penalty on any person who fails to pay the amount of tax that is required to be shown on a return but that is not so shown. However, a penalty-free period is provided if a taxpayer pays the tax due within a certain number of days after the date of the notice and demand for payment. Section 303(b)(2) of TBOR2 amended section 6651(a)(3) to extend the penalty-free period. Therefore, proposed § 301.6651–1(a)(3) extends the penalty-free period from 10 days to 21 calendar days after the date of the notice and demand (10 business days if the amount for which the notice and demand is made equals or exceeds $100,000) with respect to any notice and demand made after December 31, 1996. In addition, the proposed regulations amend § 301.6651–1(a)(3) to conform with changes made by section 1502(b) of the Tax Reform Act of 1986 (Pub. L. No. 99–514, 100 Stat. 2085 (1986)) to repeal the special coordination rule under section 6651(c)(1)(B).

Section 6651(a)(2) imposes a penalty on any person who fails to pay the amount of tax shown on a return by the payment due date (including extensions). Pursuant to section 6020(b), if a taxpayer does not file a tax return, the Secretary can make a substitute return for the taxpayer. Prior to TBOR2, a taxpayer with a substitute return was not subject to a section 6651(a)(2) penalty because the substitute return was not treated as a return for purposes of the penalty. See Rev. Rul. 76–562, 1976–2 C.B. 430. Section 1301 of TBOR2 amended section 6651 to apply the section 6651(a)(2) failure to pay penalty to returns prepared by the Secretary pursuant to section 6020(b). Thus, for returns due (determined without regard to extensions) after July 30, 1996, proposed § 301.6651–1(g) provides that a taxpayer with a substitute return may be subject to a failure to pay penalty under section 6651(a)(2).

Section 6656 imposes a penalty for failure to deposit taxes with a government depository by the prescribed due date. Section 304 of TBOR2 amended section 6656 to provide exceptions to the failure to deposit penalty for first time depositors of employment taxes. Accordingly, § 301.6656–3(a) of the proposed regulations provides that in the case of first time depositors of employment taxes, the Secretary will generally waive the penalty for failure to deposit if (1) the failure to deposit is inadvertent based on all the facts and circumstances, (2) the depositing entity meets certain net worth requirements, (3) the failure to deposit occurs during the first quarter the depositing entity is required to deposit any employment tax, and (4) the return for the employment tax is filed on time.

In addition, proposed § 301.6656–3(b) provides that the Secretary may abate any penalty for failure to make deposits if the first time a depositor is required to make a deposit, the amount required to be deposited is inadvertently sent to the Secretary instead of to the appropriate government depository. Proposed § 301.6656–3 applies to deposits required to be made after July 30, 1996.

Joint Returns

Prior to TBOR2, married individuals making an election under section 6013(b) to file a joint return after filing a separate return for the same taxable year were required to pay the full amount of the tax shown on the joint return at or before the time of filing the

joint return. With respect to taxable years beginning after July 30, 1996, section 402 of TBOR2 amended section 6013(b) to permit married individuals who previously filed separate returns to file joint returns for the same taxable year without paying the full amount of tax shown on the joint return. Accordingly, § 1.6013–2(b)(1) of the proposed regulations provides that the full payment requirement applies only to taxable years beginning on or before July 30, 1996.

Levy and Compromise

Section 6334 lists the items of property that are exempt from levy by the IRS. Section 502 of TBOR2 amended section 6334 to (1) increase the dollar amount exempt from levy under section 6334(a)(2) and provide that this exemption amount applies to all taxpayers, not just heads of a family; (2) increase the dollar amount exempt from levy under section 6334(a)(3); and (3) provide a yearly inflation adjustment for the dollar amounts exempt from levy. In addition, section 110(l)(6) of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, in a conforming amendment, amended section 6334(a)-(11)(A) to delete the language ''(relating to aid to families with dependent children)''.

Accordingly, § 301.6334–1(a)(2) of the proposed regulations increases from $1,650 ($1,550 in the case of levies issued during 1989) to $2,500 the amount exempt from levy for fuel, provisions, furniture, and personal effects, and makes this exemption applicable to all taxpayers, not just taxpayers who are heads of a family. The proposed regulations also increase from $1,100 ($1,050 in the case of levies issued during 1989) to $1,250 the amount exempt from levy for books and tools of a trade, business, or profession. These changes are effective with respect to levies issued after December 31, 1996. In addition, for calendar years beginning after 1997, § 301.6334–1(e) of the proposed regulations provides an inflation adjustment for the exemption amounts described above and for rounding to the nearest multiple of $10.

Prior to the enactment of TBOR2, section 7122(b) required the General Counsel of the Treasury or his delegate to file an opinion with the Secretary whenever the Secretary compromised a case, unless the compromise involved a civil case in which the unpaid amount of the tax assessed (including any interest, additional amount, addition to the tax, or assessable penalty) was less than $500. Effective July 30, 1996, section 503 of TBOR2 amended section 7122 to raise the dollar threshold for mandatory review of compromises of civil cases by the General Counsel of the Department of Treasury or his delegate from $500 to $50,000. Accordingly, § 301.7122–1(e) of the proposed regulations provides that for compromises accepted on or after July 30, 1996, no opinion is required if the unpaid amount of tax is less than $50,000.

Awarding of Costs and Certain Fees

In general, under section 7430 a prevailing party may recover the reasonable administrative or litigation costs incurred in an administrative or a civil proceeding if the proceeding relates to the determination, collection, or refund of any tax, interest, or penalty. Prior to TBOR2, the taxpayer had the burden of proving that the position of the United States was not substantially justified. Section 701 of TBOR2 amended section 7430(c)(4) to place on the government the burden of proving that the position of the United States is substantially justified. Under TBOR2, the position of the government will be presumed not to be substantially justified if the IRS did not follow its applicable published guidance. Section 701 defines applicable published guidance.

The proposed regulations reflect these changes. Further, § 301.7430–5(c)(3) of the proposed regulations clarifies that in the definition of applicable published guidance, ''regulations'' means final and temporary regulations. The proposed regulations also clarify the period during which and the issues upon which the position of the United States is presumed to be not substantially justified.

Section 702 of TBOR2 amended section 7430(c)(1) to increase the allowable hourly rate of an award of attorney's fees and provide for a yearly inflation adjustment and rounding. Sections 301.7430–2 and 301.7430–4 of the proposed regulations reflect these changes.

Finally, section 703 of TBOR2 amended section 7430(b)(1) to clarify that any failure to agree to an extension of the statute of limitations will not affect the determination of whether a taxpayer has exhausted administrative remedies as a prerequisite to recovery of attorney's fees. Although this is consistent with an example in the prior regulations (Example 4, § 301.7430–1(f)), the proposed regulations add § 301.7430–1(b)(4) to reflect the statutory language.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that the regulations in this document will not have a significant economic impact on a substantial number of small entities. This certification is based on a determination that in the past only an average of 38 taxpayers per year, the majority of whom were individuals, have filed a request to recover administrative costs. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these regulations are Beverly A. Baughman and Donna J. Welch, Office of Assistant Chief Counsel (Income Tax and Accounting), Robert A. Miller and Kevin B. Connelly, Office of Assistant Chief Counsel (General Litigation), and Thomas D. Moffitt, Office of Assistant Chief Counsel (Field Service). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.6013–2(b)(1) is amended by removing the language ''Unless'' and adding ''Beginning on or before July 30, 1996, unless'' in its place.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 3. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 4. Section 301.6334–1 is amended by:

1. Revising paragraph (a)(2).

2. Removing the language ''$1,100 ($1,050 for levies issued prior to January 1, 1990)'' from paragraph (a)(3) and adding ''$1,250'' in its place.

3. Removing the language ''(relating to aid to families with dependent children)'' from paragraph (a)(11)(i).

4. Redesignating paragraph (e) as paragraph (f) and adding a new paragraph (e).

5. Revising newly designated paragraph (f).

The additions and revisions read as follows:

§ 301.6334–1 Property exempt from levy.

(a) * * *

(2) *Fuel, provisions, furniture, and personal effects.* So much of the fuel, provisions, furniture, and personal effects in the taxpayer's household, and of the arms for personal use, livestock, and poultry of the taxpayer, that does not exceed $2,500 in value.

* * * * *

(e) *Inflation adjustment.* For any calendar year beginning after December 31, 1997, each dollar amount referred to in paragraphs (a)(2) and (a)(3) of this section will be increased by an amount equal to the dollar amount multiplied by the cost-of-living adjustment determined under section 1(f)(3) for the calendar year (substituting ''calendar year 1996'' for ''calendar year 1992'' in section 1(f)(3)(B)). If any dollar amount as adjusted is not a multiple of $10, the dollar amount will be rounded to the nearest multiple of $10 (rounding up if the amount is a multiple of $5).

(f) *Effective date.* Generally, these provisions are effective with respect to levies made on or after July 1, 1989. However, any reasonable attempt by a taxpayer to comply with the statutory amendments addressed by the regulations in this section prior to February 21, 1995, will be considered as meeting the requirements of the regulations in this section. In addition, paragraphs (a)(2), (a)(3), (a)(11)(i) and (e) of this section are applicable with respect to levies issued after December 31, 1996.

Par. 5. Section 301.6601–1 is amended by:

1. Revising paragraphs (f)(3) and (f)(4).

2. Redesignating paragraph (f)(5) as paragraph (f)(6) and adding new paragraph (f)(5).

The additions and revisions read as follows:

§ 301.6601–1 Interest on underpayments.

* * * * *

(f) * * *

(3) Interest will not be imposed on any assessable penalty, addition to the tax, or additional amount if the amount is paid within 21 calendar days (10 business days if the amount stated in the notice and demand equals or exceeds $100,000) from the date of the notice and demand. If interest is imposed, it will be imposed only for the period from the date of the notice and demand to the date on which payment is received. This paragraph (f)(3) is applicable with respect to any notice and demand made after December 31, 1996.

(4) If notice and demand is made after December 31, 1996, for any amount and the amount is paid within 21 calendar days (10 business days if the amount equals or exceeds $100,000) from the date of the notice and demand, interest will not be imposed for the period after the date of the notice and demand.

(5) For purposes of paragraphs (f)(3) and (f)(4) of this section—

(i) The term *business day* means any day other than a Saturday, Sunday, legal holiday in the District of Columbia, or a statewide legal holiday in the state where the taxpayer resides or where the taxpayer's principal place of business is located. With respect to the tenth business day (after taking into account the first sentence of this paragraph (f)(5)(i)), see section 7503 relating to time for performance of acts where the last day falls on a statewide legal holiday in the state where the act is required to be performed.

(ii) The term *calendar day* means any day. With respect to the twenty-first calendar day, see section 7503 relating to time for performance of acts where the last day falls on a Saturday, Sunday, or legal holiday.

* * * * *

Par. 6. Section 301.6651–1 is amended by:

1. Revising paragraph (a)(3).

2. Adding paragraph (g).

The additions and revisions read as follows:

§ 301.6651–1 Failure to file tax return or to pay tax.

(a) * * *

(3) *Failure to pay tax not shown on return.* In the case of failure to pay any amount of any tax required to be shown on a return specified in paragraph (a)(1) of this section that is not so shown (including an assessment made pursuant to section 6213(b)) within 21 calendar days from the date of the notice and demand (10 business days if the amount for which the notice and demand is made equals or exceeds $100,000) with respect to any notice and demand made after December 31, 1996, there will be added to the amount stated in the notice and demand the amount specified below unless the failure to pay the tax within the prescribed time is shown to the satisfaction of the district director or the director of the service center to be due to reasonable cause and not to willful neglect. The amount added to the tax is 0.5 percent of the amount stated in the notice and demand if the failure is for not more than 1 month, with an additional 0.5 percent for each additional month or fraction thereof during which the failure continues, but not to exceed 25 percent in the aggregate.

* * * * *

(g) *Treatment of returns prepared by the Secretary*—(1) *In general.* A return prepared by the Secretary under section 6020(b) will be disregarded for purposes of determining the amount of the addition to tax for failure to file any return pursuant to paragraph (a)(1) of this section. However, the return prepared by the Secretary will be treated as a return filed by the taxpayer for purposes of determining the amount of the addition to tax for failure to pay the tax shown

on any return and for failure to pay the tax required to be shown on a return that is not so shown pursuant to paragraphs (a)(2) and (a)(3) of this section, respectively.

(2) *Effective date.* This paragraph (g) applies to returns the due date for which (determined without regard to extensions) is after July 30, 1996.

Par. 7. Section 301.6656–3 is added to read as follows:

§ 301.6656–3 Abatement of penalty.

(a) *Exception for first time depositors of employment taxes*—(1) *Waiver.* The Secretary will generally waive the penalty imposed by section 6656(a) on a person's failure to deposit any employment tax under subtitle C of the Internal Revenue Code if—

(i) The failure is inadvertent;

(ii) The person meets the requirements referred to in section 7430(c)(4)(A)(ii) (relating to the net worth requirements applicable for awards of attorney's fees);

(iii) The failure occurs during the first quarter that the person is required to deposit any employment tax; and

(iv) The return of the tax is filed on or before the due date.

(2) *Inadvertent failure.* For purposes of paragraph (a)(1)(i) of this section, the Secretary will determine if a failure to deposit is inadvertent based on all the facts and circumstances.

(b) *Deposit sent to Secretary.* The Secretary may abate the penalty imposed by section 6656(a) if the first time a depositor is required to make a deposit, the amount required to be deposited is inadvertently sent to the Secretary instead of to the appropriate government depository.

(c) *Effective date.* This section applies to deposits required to be made after July 30, 1996.

Par. 8. Paragraph (e) of § 301.7122–1 is revised to read as follows:

§ 301.7122–1 Compromises.

* * * * *

(e) *Record*—(1) *In general.* If an offer in compromise is accepted, there will be placed on file the opinion of the Chief Counsel of the IRS with respect to the compromise, with the reasons for the opinion, and including a statement of—

(i) The amount of tax assessed;

(ii) The amount of interest, additional amount, addition to the tax, or assessable penalty, imposed by law on the person against whom the tax is assessed; and

(iii) The amount actually paid in accordance with the terms of the compromise.

(2) *Exception.* For compromises accepted on or after July 30, 1996, no opinion will be required with respect to the compromise of any civil case in which the unpaid amount of tax assessed (including any interest, additional amount, addition to the tax, or assessable penalty) is less than $50,000. However, the compromise will be subject to continuing quality review by the Secretary.

* * * * *

Par 9. Section 301.7430–0 is amended by:

1. Adding under the heading § 301.7430–1, a caption (b)(4) to read ''(4) Failure to agree to extension of time for assessments.''.

2. Adding under the heading § 301.7430–5, a caption (c)(3) to read ''(3) Presumption.''.

Par. 10. Section 301.7430–1 is amended by adding paragraph (b)(4) to read as follows:

§ 301.7430–1 Exhaustion of administrative remedies.

* * * * *

(b) * * *

(4) *Failure to agree to extension of time for assessments.* Any failure by the prevailing party to agree to an extension of the time for the assessment of any tax will not be taken into account for purposes of determining whether the prevailing party has exhausted the administrative remedies available to the party within the IRS.

* * * * *

Par. 11. Section 301.7430–2 is amended by:

1. Removing the language ''7430(c)(4)(B)(ii)'' from the third sentence of paragraph (b)(2) and adding ''7430(c)(4)(C)(ii)'' in its place.

2. Revising paragraph (c)(3)(i)(B).

3. Removing the language ''If more than $75'' from paragraph (c)(3)(ii)(C) and adding ''In the case of administrative proceedings commenced after July 30, 1996, if more than $110'' in its place.

The revision reads as follows:

§ 301.7430–2 Requirements and procedures for recovery of reasonable administrative costs.

* * * * *

(c) * * *

(3) * * *

(i) * * *

(B) A clear and concise statement of the reasons why the taxpayer alleges that the position of the IRS in the administrative proceeding was not substantially justified. For administrative proceedings commenced after July 30, 1996, if the taxpayer alleges that the IRS did not follow any applicable published guidance, the statement must identify all applicable published guidance that the taxpayer alleges that the IRS did not follow. For purposes of this paragraph (c)(3)(i)(B), the term *applicable published guidance* means final or temporary regulations, revenue rulings, revenue procedures, information releases, notices, announcements, and, if issued to the taxpayer, private letter rulings, technical advice memoranda, and determination letters. Also, for purposes of this paragraph (c)(3)(i)(B), the term *administrative proceeding* includes only those administrative proceedings or portions of administrative proceedings occurring on or after the administrative proceeding date as defined in § 301.7430–3(c).

* * * * *

Par. 12. Section 301.7430–4 is amended by:

1. Removing the language ''$75'' from paragraph (b)(3)(i) and adding '', in the case of proceedings commenced after July 30, 1996, $110'' in its place.

2. Revising paragraph (b)(3)(ii).

3. Removing the language ''$75'' from the first, second, and third sentences of paragraph (b)(3)(iii)(B) and adding ''$110'' in its place.

4. Removing the language ''$75'' from paragraph (b)(3)(iii)(C) and adding ''$110'' in its place.

5. Removing the language ''$75'' from the third sentence of the example in paragraph (b)(3)(iii)(D) and adding ''$110'' in its place.

6. Removing the language ''$75'' from the second and third sentences of paragraph (c)(2)(ii) and adding ''$110'' in its place.

The revision reads as follows:

§ 301.7430–4 Reasonable administrative costs.

* * * * *

(b) * * *

(3) * * *

(ii) *Cost of living adjustment.* The IRS will make a cost of living adjustment to the $110 per hour limitation for fees incurred in any calendar year beginning after December 31, 1996. The cost of living adjustment will be an amount equal to $110 multiplied by the cost-of-living adjustment determined under section 1(f)(3) for the calendar year (substituting ''calendar year 1995'' for ''calendar year 1992'' in section 1(f)(3)(B)). If the dollar limitation as adjusted by this cost-of-living increase is not a multiple of $10, the dollar amount will be rounded to the nearest multiple of $10 (rounding up if the amount is a multiple of $5).

* * * * *

Par. 13. Section 301.7430–5 is amended by:

1. Revising paragraph (a).

2. Adding paragraph (c)(3).

The addition and revision read as follows:

§ 301.7430–5 Prevailing party.

(a) *In general.* For purposes of an award of reasonable administrative costs under section 7430 in the case of administrative proceedings commenced after July 30, 1996, a taxpayer is a prevailing party only if—

(1) The position of the IRS was not substantially justified;

(2) The taxpayer substantially prevails as to the amount in controversy or with respect to the most significant issue or set of issues presented; and

(3) The taxpayer satisfies the net worth and size limitations referenced in paragraph (f) of this section.

* * * * *

(c) * * *

(3) *Presumption.* If the IRS did not follow any applicable published guidance in an administrative proceeding commenced after July 30, 1996, the position of the IRS, on those issues to which the guidance applies and for all periods during which the guidance was not followed, will be presumed not to be substantially justified. This presumption may be rebutted. For purposes of this paragraph (c)(3), the term *applicable published guidance* means final or temporary regulations, revenue rulings, revenue procedures, information releases, notices, announcements, and, if issued to the taxpayer, private letter rulings, technical advice memoranda, and determination letters. Also, for purposes of this paragraph (c)(3), the term *administrative proceeding* includes only those administrative proceedings or portions of administrative proceedings occurring on or after the administrative proceeding date as defined in § 301.7430–3(c).

* * * * *

Par. 14. Section 301.7430–6 is revised to read as follows:

§ 301.7430–6 Effective date.

Sections 301.7430–2 through 301.7430–6, other than §§ 301.7430–2(b)(2), (c)(3)(i)(B), (c)(3)(ii)(C), and (c)(5); §§ 301.7430–4(b)(3)(i), (b)(3)(ii), (b)(3)(iii)(B), (b)(3)(iii)(C), (b)(3)(iii)(D), and (c)(2)(ii); and §§ 301.7430–5(a) and (c)(3), apply to claims for reasonable administrative costs filed with the IRS after December 23, 1992, with respect to costs incurred in administrative proceedings commenced after November 10, 1988. Section 301.7430–2(c)(5) is applicable March 23, 1993. Section 301.7430–0, §§ 301.7430–2(b)(2), (c)(3)(i)(B), and (c)(3)(ii)(C); §§ 301.7430–4(b)(3)(i), (b)(3)(ii), (b)(3)(iii)(B), (b)(3)(iii)(C), (b)(3)(iii)(D), and (c)(2)(ii); and §§ 301.7430–5(a) and (c)(3) are applicable for administrative proceedings commenced after July 30, 1996.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 31, 1996, 8:45 a.m., and published in the issue of the Federal Register for January 2, 1997, 62 F.R. 77)

Deletions From Cumulative List of Organizations Contributions to Which Are Deductible Under Section 170 of the Code

Announcement 97-13

The name of an organization that no longer qualifies as organization described in section 170(c)(2) of the Internal Revenue Code of 1986 is listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on February 24, 1997, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual who was responsible, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

A Taste of Orange County, Inc., Irvine, CA

Foundations Status of Certain Organizations

Announcement 97–14

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Aikanes O Hawaii Inc., Tampa, FL

Armi Housing Corporation, New York, NY

Chimes for Charity Inc., Union City, TN

Chittenden County Senior Citizens Alliance Inc., Burlington, VT

Clifford L. Williams Memorial Foundation, Jena, LA
CNCA Foundation, Grand Island, NE
Commission on Interprofessional Education and Practice Inc., Columbus, OH
Concerned Citizens for Better Health Care, Carrollton, IL
Cornelius R. Coffey Aviation Education Foundation, Chicago, IL
Dixon Foundation, Dallas, TX
Dynamic Adventures, Nine Miles Falls, WA
Educational Charities Corporation, Chicago, IL
Educational Fund of the Bar Association of McCracken County Kentucky, Inc., Paducah, KY
Emmaus Counseling Center, Springfield, IL
Employment and Training Service Providers Association, Chicago, IL
First United Methodist Church Foundation, Anchorage, AK
Florida Education and Research Foundation Inc., Palm Bay, FL
Foundation for Birmingham Senior Residents, Birmingham, MI
Foundation for the Education of Future Machinist, Northfield, IL
Friends of Ogden School Inc., Chicago, IL
Genesis Project Industrial Magnate School, Chicago, IL
Genetics Institute Research and Education Foundation, Pasadena, CA
Help at Home Services, Inc., Chicago, IL
Heritage Dance Foundation Inc., Goldsboro, NC
Ignatius De Cicco Veterans Charitable Trust, Albuquerque, NM
Illinois Junior Golf Association, Golf, IL
Illinois Pediatric Brain Injury Resource Center, Algonquin, IL
Independent Relation Organization, Chicago, IL
In Focus Productions Inc., Evanston, IL
International Cinema Museum, Glenview, IL
Iranian American Society, Chicago, IL
Jackson Park Golfers Association, Chicago, IL
Jubilee Foundation Inc., Reedsburg, WI
Juvenile Charities Foundation, Chicago, IL
Kids Say No Foundation, Elk Grove Village, IL
Law Enforcement Racers Against Drugs LERAD, Las Vegas, NV
Learning Logic Foundation, Chicago, IL
L H Geddes Memorial Fund, Rockford, IL
Lift Up Our Heart Charitable Trust, Leawood, KS
Little Village Community Corporation, Chicago, IL
Love Inc. of Greater Rockford, Rockford, IL
Maywood Phoenix Homes Inc., Indianapolis, IN
M B Fund, Chicago, IL
Midwest Migrant Health Consortium, Chicago, IL
Monroe Foundation, Chicago, IL
MSAA Accessible Housing for the Handicapped, Inc., Oaklyn, NJ
MSAA Housing for Independent Living, Inc., Oaklyn, NJ
MSAA Housing for the Disabled, Inc., Oaklyn, NJ
National Industrial Belting Association Scholarship Fund, Brookfield, WI
NBC-USA Housing Inc., Thirteenth, Newark, OH
New Hope Multi Service Agency, Inc., New York, NY
No. Seven Township Rescue Squad Inc., New Bern, NC
Operation Christmas of Romeoville, Romeoville, IL
Paradise Haven Outreach Inc., Los Angeles, CA
Parent for a Manitowoc Teen Center Inc., Manitowoc, WI
Phoenix Lodge Inc., Rockford, IL
Portsmouth Development Corporation, Portsmouth, VA
Project Noahs Ark Foundation, Beverly Hills, CA
PVC Trust Fund, Ann Arbor, MI
Restaurants United To Serve the Homeless, Inc., Louisville, KY
Safe Haven Incorporated, Sacramento, CA
S Avenue Big Brothers Inc., Riviera Beach, FL
Senior Care Recreation Center Inc., Indianapolis, IN
Sian Ka An Biosphere Foundation, Minneapolis, MN
Sigma Pi Fraternity Educational Fund of San Diego Inc., San Diego, CA
Silk for Life Project, Inc., Milwaukee, WI
Sind Medical Association of North America, Milwaukee, WI
Society of Noise Reductionists Inc., St. Paul, MN
Solid Rock Ministries Inc., Maplewood, MN
Solu Foundation for Community Development, St. Paul, MN
South Asian Ministries LTD, Greenfield, WI
St. Cloud Area Golden Gloves Inc., Sauk Rapids, MN
St. Luke Residential Health Care Facility, Inc., Oswego, NY
Thief River Falls Technical College Foundation, Thief River Falls, MN
30th Street Industrial Corridor Corp. Inc., Milwaukee, WI
Towing Operators Working To Eliminate Drunk Driving, Champlin, MN
United Community Foundation Inc., Janesville, WI
United Soccer Club of West Bend Inc., West Bend, WI
Up and Out of Poverty-Minnesota, Minneapolis, MN
Voiceprint, St. Paul, MN
Western North Carolina Sports, Inc., Asheville, NC
White Bear Lake Basketball Association, Minneapolis, MN
Wings as Eagle Mission Air Service Inc., Nevis, MN
Wisconsin Association of Nutrition Directors Inc., Hayward, WI
Wisconsin Geriatrics Society Inc., Madison, WI
Wisconsin Mortgage Bankers Education Foundation Inc., Madison, WI
Worlds Largest Snowmobile Museum, Eden Valley, MN

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under Section 330, Title 31 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent, or enrolled actuary, and date of disbarment or period of suspension. This announcement will appear in the weekly Bulletin for five successive weeks or as long as it is practicable for each attorney, certified public accountant, enrolled agent, or enrolled actuary so suspended or disbarred and will be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing before an administrative law judge, the following individuals have been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Noske, Joan Marie	Bismarck, ND	CPA	September 7, 1996
Dalrymple, John K.	Troy, MI	CPA	September 26, 1996

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[1]A cumulative list of all Revenue Rulings, Revenue Procedures, Treasury Decisions, etc., published in Internal Revenue Bulletins 1996–27 through 1996–53 will be found in Internal Revenue Bulletin 1997–1, dated January 6, 1997.

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[1]A cumulative finding list for previously published items mentioned in Internal Revenue Bulletins 1996–27 through 1996–53 will be found in Internal Revenue Bulletin 1997–1, dated January 6, 1997.